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MASTER INDEX

Corporate Secretary's Encyclopedia

Corporate Secretary's Encyclopedia

PREPARED WITH THE COOPERATION
OF THE EDITORIAL STAFF OF
PRENTICE-HALL, INC.

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VOLUME THREE

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NOTE

The forms contained in this book have been carefully selected in order to cover the situations and problems of the subject matter as completely as possible. They will be useful for adaptation to specific situations in connection with which they are to be used. Laymen will find them informative on the contingencies and problems which should be considered, but should consult their own legal counsel before entering into any contract or business arrangement based on these forms.

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PREFACE

Whether you are a corporate secretary interested in organizing and recording meetings, a director concerned with a corporation's powers and liabilities, an officer involved in activities such as stock and bond issuance and transfers, an attorney advising management on such activities as dividends payments, or just a layman interested in corporate affairs, this new four-volume Encyclopedia is meant for you.

It contains the basic legal principles applicable to each of the corporate activities it describes. Because these principles are stated in non-technical language, legal training to understand them is not needed. Nevertheless, they are backed up by citations to both leading and recent cases.

The Encyclopedia contains skillfully drawn and legally tested forms to enable the corporation to carry out these activities—forms selected with particular attention to their adaptability to varying situations.

It contains step-by-step accounts of the practical procedures developed by some of the leading corporations in the country for careful and yet rapid handling of the mechanics of these same activities.

In short, it is a true Encyclopedia, covering all aspects of the major activities carried on by a corporation as a legal entity.

Although, by request, we have removed from the text and illustrations all identifying material, we gratefully acknowledge the cooperation of the many corporations, both large and small, which permitted us to make personal investigations of their methods. We thank also the officers and employees of those corporations, who were so generous in the giving of their time and information through interviews and letters. Without this help, the Encyclopedia would not have been possible.

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Corporate Secretary's Encyclopedia

CHAPTER 17

CLASSIFICATION OF STOCK

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Classification of Stock

Definition of capital stock, capital, and stock. The authorized capital stock of a corporation is the amount or number of shares of stock that it is empowered to issue. This sum or number is fixed by the articles of incorporation and remains the same unless and until increased or reduced by amendment or otherwise in the manner provided by law.¹ Capital stock has also been defined as the aggregate sum of money or other valuable thing contributed by the stockholders and paid into the treasury of the corporation for use in the exercise of its corporate functions.² This definition applies to capital stock that has actually been issued.³ The authorized capital stock that has not been issued is known as unissued capital stock.⁴

The capital of a corporation must be distinguished from its capital stock.⁵ The capital is the actual property or estate of the company, either in money or property.⁶ It includes the consideration received

¹ *Powers v. Detroit, G. H. & M. Ry.*, (1906) 201 U.S. 543, 26 S. Ct. 556; *Scovill v. Thayer*, (1882) 105 U.S. 143; *Randle v. Winona Coal Co.*, (1921) 206 Ala. 254, 89 So. 790; *Dominguez Land Corp. v. Daugherty*, (1925) 196 Cal. 468, 238 P. 703; *John W. Cooney Co. v. Arlington Hotel Co.*, (1917) 11 Del. Ch. 286, 101 A. 879; *Randall v. Mickle*, (1931) 103 Fla. 1229, 138 So. 14, 141 So. 317; *Central Ill. Pub. Serv. Co. v. Swartz*, (1918) 284 Ill. 108, 119 N.E. 990; *Cunningham v. Commissioner*, (1924) 249 Mass. 401, 144 N.E. 447; *Brooks v. Buys*, (1922) 217 Mich. 263, 186 N.W. 472; *State ex rel. Corinne Realty Co. v. Becker*, (1928) 320 Mo. 908, 8 S.W.(2d) 970; *People ex rel. Commercial Cable Co. v. Morgan*, (1904) 178 N.Y. 433, 70 N.E. 967; *Person v. Board*, (1922) 184 N.C. 499, 115 S.E. 336; *Commonwealth Bonding & Cas. Ins. Co. v. Hollifield*, (1916) (Tex. Civ. App.) 184 S.W. 776.

² *State v. Guaranty Sav. Bldg. & Loan Ass'n*, (1932) 225 Ala. 481, 144 So. 104. See also *Chicago, Milwaukee, St. Paul & Pac. R.R. v. Harmon*, (1931) 89 Mont. 1, 295 P. 762; *Rensselaer County Agricultural & Horticultural Soc'y v. Weatherwax*, (1931) 255 N.Y. 329, 174 N.E. 699.

³ It has been said that stock is issued when certificates of stock are officially executed and delivered by the corporation to its stockholders. *Majestic Household Utilities Corp. v. Stratton*, (1933) 353 Ill. 86, 186 N.E. 522. Note, however, that the issuance of a certificate of stock is not necessary for the existence and validity of stock. When stock is paid for, it is in fact issued, irrespective of the issuance of the certificate. *Savic v. Kramlich*, (1932) 52 Idaho 156, 12 P.(2d) 260.

⁴ Unissued stock merely represents the right to admit new stockholders and has no value in itself. *Chicago, Milwaukee, St. Paul & Pac. R.R. v. Harmon*, *supra* (Note 2).

⁵ *Canfield v. Morristown Fire Ass'n*, (1851) 23 N.J.L. 195; *People ex rel. Union Trust Co. v. Coleman*, (1891) 126 N.Y. 433, 27 N.E. 818; *Tradesman Publishing Co. v. Knoxville Car Wheel Co.*, (1895) 95 Tenn. 634, 32 S.W. 1097.

⁶ *Malley v. Old Colony Trust Co.*, (1924) 299 F. 523; *Smith v. Dana*, (1905) 77 Conn.

for issued capital stock plus gains or profits from the use and investment of such consideration; or, if losses have resulted, the capital consists of what remains after such losses have been deducted. Although the capital stock is fixed, the capital may vary. The capital may be greater than the capital stock, and this fact is what gives the shares of stock of a corporation having par value a worth greater than their par value on the market; or the capital may be less than the capital stock, in which case the shares of stock will be worth less on the market than their par value; or, if the company has suffered the loss of all its property, it will have no capital at all, and its shares of stock will have no value on the market.⁷ That portion of the capital which is over and above the issued capital stock is called the surplus. The corporation, not the stockholders, owns the capital.⁸

The term "stock," while it may mean capital stock or capital,⁹ is commonly used to designate the shares of the capital stock in the hands of individual stockholders,¹⁰ or the certificates issued by the company to them.¹¹ Stock, understood in this sense, is an interest in the corporate property¹² belonging, not to the corporation, but to the individual stockholders.¹³

Shares of stock as property. The shares of the capital stock of a corporation are personal property,¹⁴ possessing all the characteristics

543, 60 A. 117; *Sohland v. Baker*, (1928) 15 Del. Ch. 431, 141 A. 277; *Turner v. Cattleman's Trust Co.*, (1919) (Tex. Civ. App.) 215 S.W. 831; *Estate of Wells*, (1913) 156 Wis. 294, 144 N.W. 174.

⁷ *Wells v. Green Bay & Mississippi Canal Co.*, (1895) 90 Wis. 442, 64 N.W. 69.

⁸ *Commonwealth v. Charlottesville Perpetual Bldg. & Loan Co.*, (1894) 90 Va. 790, 20 S.E. 364.

⁹ *Markle v. Burgess*, (1911) 176 Ind. 25, 95 N.E. 308.

¹⁰ *Wright v. Georgia R.R. & Banking Co.*, (1910) 216 U.S. 420, 30 S. Ct. 242; *In re Sutherland*, (1927) 21 F.(2d) 667; *Hall & Farley v. Alabama Terminal & Improvement Co.*, (1911) 173 Ala. 398, 56 So. 235; *Hayes v. St. Louis Union Trust Co.*, (1927) 317 Mo. 1028, 298 S.W. 91; *Frank Gilbert Paper Co. v. Prankard*, (1923) 204 App. Div. 8.3, 198 N.Y. Supp. 25; *Black Eagle Mining Co. v. Conroy*, (1923) 94 Okla. 199, 221 P. 425.

¹¹ *Crocker v. Crocker*, (1927) 84 Cal. App. 114, 257 P. 611; *Baker v. Bankers' Mortgage Co.*, (1927) 15 Del. Ch. 209, 135 A. 486; *Charles v. Hopkins*, (1927) 217 Ky. 842, 290 S.W. 730; *Miller v. Silverman*, (1927) 221 App. Div. 697, 224 N.Y. Supp. 609; *Whitehead v. Gormley*, (1926) 116 Okla. 287, 245 P. 562.

¹² *Morrill v. Bentley*, (1911) 150 Iowa 677, 130 N.W. 734.

¹³ *Berl v. Crutcher*, (1932) 60 F.(2d) 440; *Southern Gum Co. v. Laylin*, (1902) 66 Ohio St. 578, 64 N.E. 564; *Motter v. Kennett Township Elec. Co.*, (1905) 212 Pa. 613, 62 A. 104; *Turner v. Cattleman's Trust Co.*, *supra* (Note 6).

¹⁴ *Hook v. Hoffman*, (1915) 16 Ariz. 540, 147 P. 722; *Bellows Falls Power Co. v. Commonwealth*, (1915) 222 Mass. 51, 109 N.E. 891; *Holmes v. Camp*, (1916) 219 N.Y. 359, 114 N.E. 841; *Anderson v. First Nat'l Bank*, (Tex. Civ. App.) (1917) 191 S.W. 836; *Iron*

of other personal property.¹⁵ They may be bought and sold,¹⁶ mortgaged or pledged,¹⁷ given away¹⁸ and bequeathed, and they are subject to personal property taxes.¹⁹ In an intestate estate, they descend as personal property according to the laws of descent and distribution.²⁰

The shares of the capital stock of a corporation must be distinguished from the certificates of stock which evidence their existence.²¹

A certificate of stock is not the stock itself, but merely documentary evidence of the stockholder's interest in the corporation²²—evidence that the person named or its holder is the owner of the number of shares stated in the certificate.²³ The certificate is not essential to the existence of the shares.²⁴ A person may be a full-fledged stockholder even if no certificate of stock is issued.²⁵

City Sav. Bank v. Isaacsen, (1932) 158 Va. 609, 164 S.E. 520. Even if the entire assets of the corporation consist of land, the shares of stock are personal property. *Hamil v. Flowers*, (1909) 133 Ga. 216, 65 S.E. 961.

¹⁵ *Hawley v. Malden*, (1914) 232 U.S. 1, 34 S. Ct. 201; *Bankers' Trust Co. v. McCloy*, (1913) 109 Ark. 160, 159 S.W. 205; *Central Sav. Bank v. Smith*, (1908) 43 Colo. 90, 95 P. 307; *Morris v. Hussong Dyeing Mach. Co.*, (1913) 81 N.J. Eq. 256, 86 1026; *In re Jones*, (1902) 172 N.Y. 575, 65 N.E. 570.

¹⁶ *Farmers' Loan & Trust Co. v. Chicago Portage & Superior R.R.*, (1896) 163 U.S. 31, 16 S. Ct. 917; *Steele v. Farmers' & Merchants' Mut. Tel. Ass'n*, (1915) 95 Kan. 580, 148 P. 661; *Ingraham v. National Salt Co.*, (1902) 36 N.Y. Misc. 646, 74 N.Y. Supp. 388, *aff'd*, *memo dec.*, 72 App. Div. 582, 76 N.Y. Supp. 1016.

¹⁷ *Dueber Watch Case Mfg. Co. v. Daugherty*, (1900) 62 Ohio St. 589, 57 N.E. 455. But a pledge of unissued stock is void. *McAndrews v. Idawa Gold Mining Co.*, (1929) 54 N.D. 734, 210 N.W. 514. See also *Edmund Wright-Gensberg Co. v. Carlisle Ribbon Mills*, (1929) 105 N.J. Eq. 411, 148 A. 178.

¹⁸ *Tucker v. Curtin*, (1906) 148 F. 929; *Herbert v. Simson*, (1915) 220 Mass. 480, 108 N.E. 65; *Walker v. Dixon Crucible Co.*, (1890) 47 N.J. Eq. 342, 20 A. 885; *Talbot v. Talbot*, (1911) 32 R.I. 72, 78 A. 535.

¹⁹ *Farrington v. Tennessee* (1878) 95 U.S. 558; *Greenleaf v. Board of Review*, (1900) 184 Ill. 226, 56 N.E. 295; *Darnell v. State*, (1910) 174 Ind. 143, 90 N.E. 769.

²⁰ *State v. Dunlap*, (1916) 28 Idaho 784, 156 P. 1141; *In re Zook's Estate*, (1927) 317 Mo. 986, 296 S.W. 778.

²¹ *Eisner v. Macomber*, (1920) 252 U.S. 189, 40 S. Ct. 189; *Sargent v. Whitefield & Co.*, (1928) 226 Ky. 754, 11 S.W.(2d) 926; *Mitchell v. Newton County Bank*, (1926) 220 Mo. App. 223, 282 S.W. 729; *Miller v. M. E. Smith Bldg. Co.*, (1929) 118 Neb. 5, 223 N.W. 277.

²² *Kansas, O. & G. Ry. v. Helvering*, (1941) 124 F.(2d) 460; *Mindenberg v. Carmel Film Productions, Inc.*, (1955) 132 Cal. App. (2d) 598, 282 P.(2d) 1024; *Harris v. Chicago Title & Trust Co.*, (1930) 338 Ill. 245, 170 N.E. 285; *Millar v. Mountcastle*, (1954) 161 Ohio St. 409, 119 N.E.(2d) 626.

²³ *Laden v. Baader*, (1943) 134 N.J. Eq. 24, 34 A.(2d) 82.

²⁴ *Curtis v. Prudential Ins. Co.*, (1932) 55 F.(2d) 97; *Mau v. Montana Pac. Oil Co.*, (1928) 16 Del. Ch. 114, 141 A. 828; *Savic v. Kramlich*, *supra* (Note 5); *Illinois-Indiana Fair Ass'n v. Phillips*, (1926) 328 Ill. 368, 159 N.E. 815; *Harlan Nat'l Bank v. Carbon Glow Coal Co.*, (1956) (Ky.) 289 S.W.(2d) 200; *Gibson v. Oswalt*, (1934) 269 Mich. 300, 257 N.W. 825; *Greenspun v. Greenspun*, (1946) (Tex. Civ. App.) 194 S.W.(2d) 134.

²⁵ *Conover v. Hasselman*, (1928) 205 Iowa 100, 220 N.W. 42; *Burchett v. Louisa Light & Power Co.*, (1930) 235 Ky. 296, 31 S.W.(2d) 373.

While shares of stock are personal property, they are property of an intangible, incorporeal nature,²⁶ existing only in contemplation of law, the outward, visible evidence of which is the stock certificate. The certificate can be the subject of larceny or an action in trover.²⁷

Shares of stock represent interests in the property of the corporation²⁸ and aliquot parts of the capital stock.²⁹ It nevertheless follows from the essential nature of shares of capital stock that their owners own no part of the corporate capital and no definite portion of the corporate property or assets.³⁰

Power of corporation to classify stock. When the corporate form of enterprise first came into general use as a type of private business organization, the only kind of capital stock authorized and issued was common stock. Today, unless restrained by law or provisions of its charter, a corporation may classify its stock and provide preferences for one class of stock over another.³¹ Statutory authority for classification of capital stock may be found in many states.

Generally the certificate of incorporation contains a statement of the classes into which the capital stock of the corporation is to be divided, and the rights and preferences attaching to each of such classes. Where the certificate of incorporation contains no provision regarding classes of stock, the statutes in many states give a corporation power to divide its shares into classes by amending its articles of incorporation. If the statute or charter does not forbid, additional

²⁶ *Tappan v. Merchants' Nat'l Bank*, (1874) 86 U.S. 189; *Barber v. Morgan*, (1911) 84 Conn. 618, 80 A. 791; *Fowler v. Dickson*, (1909) 24 Del. 113, 74 A. 601; *State Banking & Trust Co. v. Taylor*, (1910) 25 S.D. 577, 127 N.W. 590; *Presnall v. Stockyards Nat'l Bank*, (1912) (Tex. Civ. App.) 151 S.W. 873.

²⁷ *Tow v. Evans*, (1942) 194 Ga. 160, 20 S.E.(2d) 922.

²⁸ *In re Putnam*, (1911) 193 F. 464; *Film Producers, Inc. v. Jordan*, (1916) 171 Cal. 664, 154 P. 605; *Oliver v. Oliver*, (1908) 118 Ga. 362, 45 S.E. 232; *Lewis v. Oscar C. Wright Co.*, (1930) 234 Ky. 814, 29 S.W.(2d) 566; *Consolidated Coal Co. v. Miller*, (1908) 236 Ill. 149, 86 N.E. 205; *People ex rel. Singer Mfg. Co. v. Wemple*, (1896) 150 N.Y. 46, 44 N.E. 787.

²⁹ *Farrington v. Tennessee*, supra (Note 19).

³⁰ *Gottfried v. Miller*, (1882) 104 U.S. 851; *Harton v. Johnston*, (1910) 166 Ala. 317, 51 So. 992; *Kohl v. Lilienthal*, (1889) 81 Cal. 378, 22 P. 689; *Bryan v. Aiken*, (1913) 10 Del. Ch. 446, 86 A. 674; *Addis v. Swofford*, (1915) (Mo.) 180 S.W. 548.

³¹ *Hamlin v. Toledo, St.L. & K.C. R.R.*, (1897) 78 F. 664; *People ex rel. Recess Exporting & Importing Corp. v. Hugo*, (1920) 191 App. Div. 628, 182 N.Y. Supp. 9. See also *Breslav v. New York & Queens Elec. Light & Power Co.*, (1936) 249 App. Div. 181, 291 N.Y. Supp. 932, aff'd, 273 N.Y. 593, 7 N.E.(2d) 708.

classes of stock may be created with priority over pre-existing classes.³²

Classes into which capital stock may be divided. The capital stock of a corporation may be divided broadly into two classes: common stock and preferred stock. The outstanding characteristic of common stock is that its holders stand upon a basis of equality of interest in corporate profits and assets.³³ Preferred stock, as its name implies, entitles its holders to some preference over another class of stock.³⁴ This preference may relate to a right to dividends, a right to vote, a right to assets of the corporation upon dissolution, or any other preference. The nature and extent of the preferences of the various classes of stock are determined by the contract between the corporation and the stockholders and between the various classes of stockholders.³⁵ This contract is evidenced by the governing statute, by the provisions of the charter and by-laws of the corporation, by the certificate of stock, and in some instances by the resolution of the directors fixing the preferences of the various classes.³⁶

Both common and preferred stock may be subdivided into various classes with distinguishing designations, each class having different attributes.³⁷ Stock may be further classified into par value and no-par value stock.

Reasons for classifying stock. Classification of stock usually results from a desire on the part of the corporation organizers (or re-organizers) to grant preference to specific investors (or groups of investors), in order to attract capital, when such investors would not

³² *Shanik v. White Sewing Mach. Co.*, (1941) 25 Del. 371, 19 A.(2d) 831. With regard to the power to reclassify stock, see page 912.

³³ *Elko Lamoille Power Co. v. Commissioner*, (1931) 50 F.(2d) 595; *General Inv. Co. v. Bethlehem Steel Corp.*, (1917) 87 N.J. Eq. 234, 100 A. 347.

³⁴ *Storrow v. Texas Consol. Compress & Mfg. Ass'n*, (1898) 87 F. 612; *Starring v. American Hair & Felt Co.*, (1937) 21 Del. Ch. 380, 191 A. 887, aff'd, memo dec., (Del.) 2 A.(2d) 249.

³⁵ Calling stock "preferred" does not of itself determine the rights of the holders, for the extent of the preference is to be determined by the terms of the contract. *Lloyd v. Pennsylvania Elec. Vehicle Co.*, (1909) 75 N.J. Eq. 263, 72 A. 16; *Lyman v. Southern Ry.*, (1928) 149 Va. 274, 141 S.E. 240.

It has been held that stock described merely as preferred means "only a stock that differs from other stock in having some sort of a preference attached to it, without expressing the special nature of the preference." *Scott v. B. & O. Ry.*, (1901) 93 Md. 475, 49 A. 327.

³⁶ See *Windhurst v. Central Leather Co.*, (1931) 107 N.J. Eq. 528, 153 A. 402.

³⁷ Stocks designated as Class A, Class B, etc. have also been issued by many corporations. These are, in effect, classes of preferred and common stock.

be satisfied merely to hold common stock. Although, as will be shown in succeeding sections, the preferences resulting from classification are varied, the basic fact remains that the usual purpose of classification is to grant intracorporate preferences as a means of attracting capital.

In close corporations, it is customary to give preferred stock to the actual investors of capital and to issue common stock, for a nominal consideration, both to such investors and to the persons who intend to be active in the business without making a substantial initial investment. The same result could be accomplished through a loan to the corporation by the actual investors, and this might even be advantageous from the point of view of taxation. But the resulting financial structure might be such that it would be impossible to furnish a financial statement that would be satisfactory for the purpose of obtaining additional working capital by means of loans or an extension of commercial credit.

Similarly, in large corporations, a segment of the investing public, desirous of obtaining steady income, has long shown an inclination to purchase preferred stock. Where such stock can be issued and publicly sold without disturbing the underlying control of existing holders of common stock, the advantages of this type of financing are immediately apparent.

Preferred stock is usually paid dividends at a fixed rate prior to any distribution of earnings to common stockholders. (See page 800.) Also, it usually is granted a priority as to the assets on liquidation. (See page 800.) These advantages generally are sufficient to attract capital, particularly where the capital investors are more interested in safety of principal and regularity of income than in having a voice in the management. Accordingly, preferred stock generally does not have the right to vote, unless dividends have been passed for a given number of regular dividend periods. (See page 800.)

Very often the purpose for which additional funds are needed may be served after the passing of time. In order that the corporation will not be burdened with the necessity of paying fixed dividends, when that time has elapsed, preferred stock usually is subject to redemption at par or at par plus a premium. (See page 801.)

The mere issuance of preferred stock does not always satisfy prospective investors. If they believe in the future of the corporation, they may decline to invest unless they are given an opportunity to participate in ultimate profits. For this reason preferred stock is often issued with conversion rights. (See page 801.)

Stock with par value. Par value stock has a definite value, fixed by the certificate of incorporation.³⁸ The value is stated in terms of dollars, but usually the stock may be issued for money, property, or services. (See page 854.)

Stock without par value. No-par value stock may be roughly defined as stock without any nominal or designated money value. Such stock may be either common or preferred. No-par value stock may be issued only when authorized by statute.³⁹ But all jurisdictions, except Nebraska, now have statutes permitting corporations to issue stock without any face or par value if provision therefor is made either in the certificate of incorporation or in any amendment thereto. If the issuance of no-par stock is not authorized at the time of incorporation, subsequent legislation may allow it.⁴⁰ Such a change, it has been held, does not fundamentally alter the contract of stockholders to whom par value stock has been previously issued.⁴¹

Constitutional provisions prohibiting the issuance of stock except for money, property, or services do not prohibit the issuance of stock without par value.⁴²

Conversion between par value and no-par value stock. Statutes in some states specifically permit stock which has been issued with a par value to be subsequently converted into stock without a par value, and vice versa. The conversion is usually effected by an amendment to the articles of incorporation. In some states, the directors must file a certificate with the designated state authorities, after the adoption of a resolution by the stockholders. Since conversion can only be done

³⁸ *G. Loewus & Co. v. Highland Queen Packing Co.*, (1939) 125 N.J. Eq. 534, 6 A.(2d) 545.

³⁹ *West Texas Utilities Co. v. Ellis*, (1939) 133 Tex. 104, 126 S.W.(2d) 13, discussed in 18 TEXAS L. REV. 67.

⁴⁰ *Randle v. Winona Coal Co.*, supra (Note 1).

⁴¹ *Grausman v. Porto Rican American Tobacco Co.*, (1923) 95 N.J. Eq. 155, 121 A. 895.

⁴² *Lewis v. Oscar C. Wright Co.*, (1930) 234 Ky. 814, 29 S.W.(2d) 566. See also *Israels*, "Problems of Par and No-par Shares, A Reappraisal," 47 COLUM. L. REV. 1279.

under statutory authority, the procedure prescribed by the statute must be strictly followed.

Attributes of preferred stock. Preferred stock has only those preferences that are specifically defined; in all other respects, preferred stock has no rights that are not shared equally with common stock.⁴³ The preference must be clearly expressed, either by direct statement or by necessary implication.⁴⁴ If no description of the preference is indicated, the stock, even though called "preferred," is treated like common stock.⁴⁵

Statutes conferring upon corporations the power to issue preferred stock vary considerably in the terms upon which preferred stock may be issued. It is necessary, therefore, when contemplating an issue of preferred stock, to consult the law of the state of incorporation.

In some states the statutory provisions are broad, and the determination of the details relative to the issuance of preferred stock is left to the corporation. Where no restrictions or limitations are placed on issuance of preferred stock, the corporation may annex such conditions to its issues of preferred stock as it may see fit, so long as such conditions are not violative of law or contrary to public policy.⁴⁶

According to the law in many states, stock may be issued with the following attributes:⁴⁷

1. With preferences as to dividends.
2. With preferences as to assets upon liquidation of the corporation.
3. With full, limited, or no voting powers.
4. With or without the right to convert the stock into stock of another class or bonds. This is called a conversion right.
5. Subject to redemption.
6. Subject to assessment.

⁴³ *Penington v. Commonwealth Hotel Constr. Corp.*, (1930) 17 Del. Ch. 188, 151 A. 228; *Grover v. Cavanagh*, (1907) 40 Ind. App. 340, 82 N.E. 104.

⁴⁴ *Holland v. National Automotive Fibres*, (1937) 22 Del. Ch. 99, 194 A. 124.

⁴⁵ *Rice & Hutchins, Inc. v. Triplex Shoe Co.*, (1929) 16 Del. Ch. 298, 147 A. 317, *aff'd*, (1930) 17 Del. Ch. 256, 152 A. 342.

⁴⁶ *Vanden Bosch v. Michigan Trust Co.*, (1929) 35 F.(2d) 643; *Coggeshall v. Georgia Land & Inv. Co.*, (1914) 14 Ga. App. 637, 82 S.E. 156.

⁴⁷ For a discussion of the various attributes of preferred stock, see I. Grossman, "Corporate Securities—Especially Common and Preferred Stock," 17 A.B.A.J. 123.

Stock with preferences as to dividends. The most common privilege attaching to preferred stock is the right to some preference in the payment of dividends, such as a right to receive a fixed percentage of the profits of the corporation before any dividend is declared on another class of stock.⁴⁸ The subject of the rights of stockholders to dividends is discussed fully in Chapter 26.

Stock with preferences as to assets on liquidation. Holders of stock preferred as to assets upon dissolution or liquidation of the corporation are entitled to be paid back the par value of their stock, or, if stock is without par value, to receive a certain fixed amount, before any amount is paid to any other class of stockholders. Of course, creditors must first be satisfied,⁴⁹ and there may not be sufficient funds remaining to pay the full par value of the stock. Sometimes the preference is designated as nonparticipating. This means that the holders will receive the full par value of their stock if there are sufficient funds, but that they cannot participate in any profits that may be remaining after all the stockholders have received payment of the amount of their shares.

Stock with restrictions as to voting. The statutes in some states expressly provide that a corporation may create classes of stock with restrictions on the voting power.⁵⁰ Irrespective of statutory authorization, however, a corporation has an inherent right to restrict the voting power, provided that the stockholder agrees to the restriction. Ordinarily, restrictions on voting power are attached to preferred rather than to common stock,⁵¹ although some statutes authorize the creation of nonvoting common shares.⁵² Common stock frequently

⁴⁸ *James F. Powers Foundry Co. v. Miller*, (1934) 166 Md. 590, 171 A. 842.

⁴⁹ In distribution upon dissolution, creditors' rights are ordinarily superior to those of stockholders. *Armstrong v. Union Trust & Sav. Bank*, (1918) 248 F. 268; *Guaranty Trust Co. v. Galveston City R.R.*, (1901) 107 F. 311; *O'Neal v. Automobile Piston & Parts Co.*, (1939) 188 Ga. 380, 4 S.E.(2d) 40; *Hoyt v. Hampe*, (1927) 206 Iowa 206, 214 N.W. 718, 220 N.W. 45; *Koepller v. Crocker Chair Co.*, (1930) 200 Wis. 476, 228 N.W. 130.

⁵⁰ See *Heller Inv. Co. v. Southern Title & Trust Co.*, (1936) 17 Cal. App.(2d) 202, 61 P.(2d) 807.

⁵¹ *Rice & Hutchins v. Triplex Shoe Co.*, supra (Note 45); *Morris v. American Pub. Utilities Co.*, (1923) 14 Del. Ch. 136, 122 A. 696; *People ex rel. Browne v. Koenig*, (1909) 133 App. Div. 756, 118 N.Y. Supp. 136; *Miller v. Ratterman*, (1890) 47 Ohio St. 141, 24 N.E. 496.

⁵² See *General Inv. Co. v. Bethlehem Steel Corp.*, supra (Note 33).

carries with it the exclusive right to vote.⁵³ The subject of voting rights of stockholders is fully treated in Chapter 3.

Stock with conversion rights. The statutes in some states expressly authorize the issuance of stock convertible into another class of stock or into bonds. However, it has been held that convertible stock may be issued even in the absence of statutory authority.⁵⁴ Ordinarily, preferred stock and not common stock is made convertible, and the option to convert is given to the stockholder rather than to the corporation. Provision is also generally made for the exercise of the option within a specified time.

When convertible stock is issued, the corporation usually makes provision to carry the conversion into effect by having available sufficient shares of stock or bond into which the issued stock may be converted.⁵⁵ A financial plan may be necessary to take care of the conversion. For example, if the stock is convertible into stock of another class, it may be necessary to effect an increase of the latter class of stock in accordance with the statutory provisions.

Stock subject to redemption. The statutes of many states authorize the issuance of redeemable stock. This means that the corporation may require the holder of such stock to surrender his shares, and accept in lieu thereof a certain sum of money. The statutes generally make the right to redeem applicable to preferred stock and not to common stock,⁵⁶ and require that the terms upon which the stock is

⁵³ See *Starring v. American Hair & Felt Co.*, *supra* (Note 34).

⁵⁴ *General Inv. Co. v. Bethlehem Steel Corp.*, *supra* (Note 33). In this case, the right of the corporation to issue convertible stock was based on its right to issue preferred stock, to retire it, and to issue common stock purchased with the proceeds of the preferred stock. The court permitted the corporation to take the short cut of issuing preferred shares convertible into common shares. See also *Berger v. U. S. Steel Corp.*, (1902) 63 N.J. Eq. 809, 53 A. 68, which holds that if the corporation may purchase its own shares, it may do so by the device of issuing the shares convertible into bonds and then buying them back with its bonds upon exercise of the conversion right.

⁵⁵ The corporation is under an obligation to use reasonable diligence in keeping itself in readiness to comply with its promise to convert. *Marony v. Wheeling & L. E. Ry.*, (1929) 33 F.(2d) 916. It has been held that one who is not a stockholder of record on the day he tenders the certificate of stock for conversion, cannot maintain an action against the corporation for its refusal to convert. *Cheatham v. Wheeling & L. E. Ry.*, (1930) 37 F.(2d) 593; 39 YALE L. J. 1209. Conversion of stock into bonds does not place the stockholder on a parity with other creditors. *In re Phoenix Hotel*, (1936) 83 F.(2d) 724.

⁵⁶ Corporation may not redeem common stock. *Starring v. American Hair & Felt Co.*, *supra* (Note 34). But see *Lewis v. H. P. Hood & Sons, Inc.*, (1954) 331 Mass. 670, 121 N.E. (2d) 850 (redeemable common stock legal), noted in 54 MICH. L. REV. 132. Maryland statute makes any class redeemable.

to be redeemed and the time when redemption may be effected, shall be set forth in the articles of incorporation or in an amendment.⁵⁷ In some states, the terms upon which the stock is to be redeemed may be fixed by a resolution of the directors providing for the issuance of the stock, pursuant to authority vested in the board of directors by the articles of incorporation, or by an amendment granting such authority. The terms of the statute, articles of incorporation, or resolution relating to the redemption must be strictly observed.⁵⁸

A corporation cannot compel a stockholder to give up his stock in redemption, unless the right to redeem has been granted to the corporation by statute, by the articles of incorporation, or by agreement with the stockholder.⁵⁹ Stock cannot be redeemed, even though the right to redeem has been granted, if the retirement of the stock will be detrimental to the interests of the corporation's creditors,⁶⁰ or will freeze the minority out of profits.⁶¹ A corporation cannot reclassify

⁵⁷ Where the charter of a corporation contains a provision for the redemption of a class of stock, that provision constitutes a contract between the classes of stockholders and between the stockholders and the corporation. *Crimmins & Peirce Co. v. Kidder Peabody Acceptance Corp.*, (1933) 282 Mass. 367, 185 N.E. 383. See also *Ammon v. Cushman Motor Works*, (1935) 128 Neb. 357, 258 N.W. 649.

⁵⁸ *State ex rel. Waldman v. Miller-Wohl Co.*, (1942) 42 Del. 73, 28 A.(2d) 148; *People ex rel. Colby v. Imbrie & Co.*, (1926) 126 N.Y. Misc. 457, 214 N.Y. Supp. 53, aff'd, memo dec., 214 N.Y. Supp. 819. In this case, an attempt by the directors to redeem stock before the redemption date was held ineffective. See *Allied Magnet Wire Corp. v. Tuttle*, (1926) 199 Ind. 166, 154 N.E. 480. See also *Corbett v. McClintic Marshall Corp.*, (1930) 17 Del. Ch. 165, 151 A. 218. In this case, the stock was redeemable at the corporation's option at \$100 per share or at book value, if the book value, as shown by the last annual statement, exceeded \$100. The directors voted to redeem the stock at the book value. A stockholder refused to surrender her shares on the ground that the price fixed did not truly reflect the book value. It was held that the directors could not be compelled to redeem at the higher and true value. The stockholder was entitled to no more relief than a decree continuing her in her status as a stockholder if she could establish that the directors were not justified in approving the values at which the assets were carried on the books.

⁵⁹ *Star Publishing Co. v. Ball*, (1922) 192 Ind. 158, 134 N.E. 285; *Empire Trust Co. v. Panola Cotton Mills*, (1929) 149 S.C. 8, 146 S.E. 612. But preferred shareholders can, by mutual arrangement with the corporation, provide for redemption of their shares on any fair basis which is not prejudicial to the corporation or to the other shareholders. *Hay v. Big Ben Land Co.*, (1949) 32 Wash.(2d) 887, 204 P.(2d) 488.

⁶⁰ *Vanden Bosch v. Michigan Trust Co.*, supra (Note 46); *In re Fechheimer Fishel Co.*, (1914) 212 F. 357; *Campbell v. Grant Trust & Sav. Co.*, (1932) 97 Ind. App. 169, 182 N.E. 267; *Westerfield-Bonte Co. v. Burnett*, (1917) 176 Ky. 188, 195 S.W. 477; *Kraft v. Rochambeau Holding Co.*, (1956) 210 Md. 325, 123 A.(2d) 287; *Miller v. M. E. Smith Bldg. Co.*, supra (Note 21); *Koeppler v. Crocker Chair Co.*, supra (Note 49).

⁶¹ *Zahn v. Transamerica Corp.*, (1951) 99 F. Supp. 808, subsequent opinion, 100 F. Supp. 461. (This case had a long history in the courts.)

preferred stock, not subject to redemption, so as to make it subject to redemption at a price below its real value.⁶²

After the redemption date, the holder of redeemable stock has no further rights as a stockholder, except to receive the redemption price of the stock.⁶³ If a corporation illegally redeems stock by a method not authorized, the owner's status as a stockholder is not changed.⁶⁴ Of course, if the corporation fails to redeem the stock, the stockholder does not lose any of his rights.⁶⁵ The board cannot change a mandatory call for the redemption of stock to an optional call, if the change is detrimental to another class of stock.⁶⁶ The statutes of many states provide that, if capital stock is refunded to the stockholders before the payment of all the debts of the corporation for which such stock would have been liable, the stockholders shall be liable to any creditor of the corporation in the amount of the sum refunded to them.⁶⁷ A stockholder who accepts the redemption price of stock offered in violation of the redemption provisions of the stock may subject himself to subsequent liability to repay the money received.⁶⁸

Under the terms of the contract between the corporation and its stockholders, the corporation may be obligated to redeem the stock at a certain time and under certain conditions.⁶⁹ The obligation will not

⁶² Breslav v. New York & Queens Elec. Light & Power Co., *supra* (Note 31).

⁶³ *In re Greenebaum Bros. & Co.*, (1945) 62 F. Supp. 769.

⁶⁴ *State ex rel. Waldman v. Miller-Wohl Co., Inc.*, *supra* (Note 58). In this case, a clause in the certificate of incorporation provided for redeeming stock "by lot or pro rata, or otherwise." The court held that the method designated by "or otherwise" had to conform in principle with the method designated "by lot or pro rata." Therefore, selection for redemption of shares belonging to stockholders who were not company officers or employees was an attempt at illegal redemption.

⁶⁵ Provision for redemption of preferred stock does not make holders thereof corporate creditors. *In re Culbertson's*, (1932) 54 F.(2d) 753. But see *Oklahoma Wheat Pool Elevator Corp. v. Bouquet*, (1937) 180 Okla. 159, 68 P.(2d) 97, in which it was held that holder of stock with an unconditional promise of redemption may be treated as a creditor and may be able to force the corporation to redeem the stock.

⁶⁶ *Taylor v. Axton-Fisher Tobacco Co.*, (1943) 295 Ky. 226, 173 S.W.(2d) 377, discussed in 42 MICH. L. REV. 530.

⁶⁷ *First Nat'l Bank v. A. Heller Sawdust Co.*, (1927) 240 Mich. 688, 216 N.W. 464.

⁶⁸ See *A. B. Leach & Co. v. Grant*, (1932) 54 F.(2d) 731, in which a stockholder was compelled to return to the receiver of the corporation, for the benefit of creditors, cash and bonds given to the stockholder in exchange for stock of the corporation pursuant to a fraudulent transaction. See also *In re Fechheimer Fishel Co.*, *supra* (Note 60).

⁶⁹ A preferred stockholder whose stock has matured is entitled to have the same redeemed pursuant to the terms of the instrument, unless the redemption of such stock cannot be done without prejudice to the rights of the creditors of the corporation, and provided that there is no fraud upon other stockholders. *Cring v. Sheller Wood Rim*

be enforced if the corporation has become insolvent and its capital stock depleted.⁷⁰ Its refusal to redeem the stock will not, in such a situation, constitute a breach of its agreement to redeem, even if the corporation is not in liquidation and no creditor demands relief.⁷¹ Usually shares cannot be redeemed if there is reasonable ground for believing that redemption would leave the corporation with less assets than liabilities.⁷² But if a corporation has actually redeemed shares under circumstances that do not prejudice existing creditors, a subsequent creditor cannot complain.⁷³

Generally, the option to redeem is exercised by the corporation by means of a resolution of the board of directors to redeem the shares in accordance with the terms of the contract.⁷⁴ After the board calls certain stock for redemption, it cannot rescind or modify its action.⁷⁵ To avoid any question as to accrued dividends, the stock is usually made redeemable on a dividend date. Notice, ordinarily from ten days to several months, is generally required.

Redemption of stock is, in effect, a purchase of the shares by the corporation.⁷⁶ When it has redeemed the stock, the corporation may either cancel and retire the stock or hold it for reissue. The mere fact that the shares have been purchased by the corporation by redemption does not mean that the shares are retired.⁷⁷ If, however, the statute governing redemption provides that redeemed stock must be retired and cannot be reissued, the corporation must cancel and retire the shares.

Redemption of stock, where it is not retired but is resold or held by the corporation for reissue, does not result in a reduction of capi-

Mfg. Co., (1932) 98 Ind. App. 310, 183 N.E. 674. See also *Koeppler v. Crocker Chair Co.*, supra (Note 49).

⁷⁰ *In re Greenebaum Bros. & Co.*, (1945) 62 F. Supp. 769. While the corporation may redeem only if it has the funds with which to do so, a person who guarantees redemption may be called upon to pay if the corporation does not do so, regardless of whether or not the corporation could be compelled to redeem. *Hamilton v. Meiks*, (1936) 210 Ind. 610, 4 N.E.(2d) 536.

⁷¹ *Booth v. Union Fibre Co.*, (1919) 142 Minn. 127, 171 N.W. 307.

⁷² *Wildermuth v. Lorain Coal & Dock Co.*, (1941) 138 Ohio St. 1, 32 N.E.(2d) 413.

⁷³ *Peoples-Pittsburgh Trust Co. v. Pittsburgh United Corp.*, (1940) 338 Pa. 328, 12 A.(2d) 430.

⁷⁴ See *Hackett v. Northern Pac. R.R.*, (1901) 36 N.Y. Misc. 583, 73 N.Y. Supp. 1087.

⁷⁵ *Taylor v. Axton-Fisher Tobacco Co.*, supra (Note 66).

⁷⁶ *Mannington v. Hocking Valley Ry.*, (1910) 183 F. 133.

⁷⁷ *Borg v. International Silver Co.*, (1926) 11 F.(2d) 143.

tal stock.⁷⁸ If the redemption and retirement of stock is made pursuant to a statutory provision relating to reduction of capital stock, the statutes governing a decrease in the capital stock must be complied with;⁷⁹ but if the stock was issued subject to redemption and retirement, and the redemption and retirement are made pursuant to the charter provision, the statutory provisions relating to a decrease in the capital stock may be disregarded.⁸⁰

Stock subject to assessment. In the absence of a statutory or charter prohibition, a corporation may issue stock with the right to demand additional payment after full consideration has been paid. A stockholder is free to make a contract with the corporation waiving certain rights and submitting to certain restrictions.⁸¹ But, once he accepts the assessment as part of his subscription contract, he is bound by it.⁸²

If the corporation issues stock without indicating that it is subject to future assessment, such stock may generally be made assessable if the statute authorizes it, or if an express agreement for the assessment, supported by a valid consideration, is made with the stockholder.⁸³ If the statute permits an assessment and the articles of incorporation contain no provision for such an assesment, the articles may subsequently be amended so as to authorize the future issuance of stock that will be subject to assessment.⁸⁴ But, as to stock already issued and fully paid, the courts are not in agreement as to whether such an amendment will affect the contractual relations among the stockholders and impair the contractual obligations.⁸⁵

⁷⁸ *Ruffner v. Sophie Mae Candy Corp.*, (1925) 35 Ga. App. 114, 132 S.F. 396. See also *Porter v. Plymouth Gold Min. Co.*, (1904) 29 Mont. 347, 74 P. 938, holding that, whether the stock is extinguished or is held as an asset for sale is largely a matter of intention on the part of the corporation.

⁷⁹ See *A. B. Frank Co. v. Latham*, (1946) 145 Tex. 30, 193 S.W.(2d) 671, in which it was held that preferred stock redeemed and canceled by corporation not in compliance with statutory provisions remained "outstanding capital stock" for franchise tax purposes.

⁸⁰ *Mannington v. Hocking Valley Ry.*, supra (Note 76).

⁸¹ *Blue Mt. Forest Ass'n v. Borrowe*, (1901) 71 N.H. 69, 51 A. 671; *Child v. Idaho Hewer Mines*, (1930) 155 Wash. 280, 284 P. 80.

⁸² *Dotson v. Hoggan*, (1914) 44 Utah 295, 140 P. 128.

⁸³ See page 896.

⁸⁴ *La Plante v. Hopper*, (1932) 127 Cal. App. 146, 15 P.(2d) 525; *Nelson v. Keith-O'Brien Co.*, (1907) 32 Utah 396, 91 P. 30.

⁸⁵ Amendment held invalid in *Garey v. St. Joe Mining Co.*, (1907) 32 Utah 497, 91 P.

Preferred stock issued in series. In some states, the certificate of incorporation may authorize the issuance of preferred stock in series. The preferences and other attributes of the authorized stock are not designated in the certificate of incorporation; the board of directors is given authority to determine the details of any series issued by a resolution adopted upon the issuance of the stock. Under such a statute, if the corporation desires to issue stock with preferences other than those already authorized, no amendment of the certificate of incorporation is necessary, the board of directors having the broad power to determine the particular qualification of the stock by resolution. If the certificate fails to make provision for the issuance of stock in series, it may subsequently be amended to include such provision, in the manner prescribed by the statute.

Stock of one series may, if the statute allows it, be converted into stock of another series, at such prices and with such adjustments as are set forth in the certificate of incorporation or any amendment thereto, or in the resolution adopted by the board of directors for the issuance of the stock.

§69. Compare *Evans v. Nellis*, (1900) 101 F. 920, in which an act doubling the liability of stockholders was held invalid.

Amendment held valid in *South Bay Meadow Dam Co. v. Gray*, (1849) 30 Me. 547; *Gardner v. Hope Ins. Co.*, (1869) 9 R.I. 194; *Fenton v. Peery Land & Livestock Co.*, (1955) 3 Utah (2d) 156, 280 P.(2d) 452. (The court in the *Fenton* case distinguished the *Garey* case, *supra*, on the basis of a change in the Utah statute.)

See also *Wilson v. Cherokee Drift Mining Co.*, (1939) 14 Cal. (2d) 56, 92 P.(2d) 802, in which it was held that a corporation could amend its articles to provide for the power of assessment and could assess its stockholders for debts existing prior to the amendment.

CHAPTER 18

SUBSCRIPTIONS TO CAPITAL STOCK

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Subscriptions to Capital Stock

Subscription to stock, as distinguished from purchase and sale of stock. A subscription to stock is a contract by which the subscriber agrees to take and pay for a certain number of shares of the capital stock of a corporation organized or about to be organized.¹ Such a contract must be distinguished from a contract for the purchase and sale of stock, which is an agreement by the corporation, on the one hand, to sell a certain number of shares for a fixed consideration, and by the purchaser, on the other, to take the stock and pay the consideration fixed.² Before incorporation, stock of the proposed corporation may be acquired only by subscription; after incorporation, it may be acquired either by subscription or by direct purchase from the corporation or from individual owners. The terms of the contract and the intention of the parties generally determine whether a particular transaction is one of subscription or one of purchase and sale.³ The distinction between a subscription and a contract for purchase and sale is important, because of the difference in the legal effect of the two contracts. If the contract is a subscription, the subscriber becomes a member of the corporation, entitled, upon acceptance of the subscription by the corporation, to all the rights and privileges, and subject to all the liabilities of a stockholder. No offer or delivery of a certificate for the shares is essential to make the subscriber a stockholder.⁴ If the contract is one of purchase and sale, the purchaser does not assume the position of stockholder until the corporation has de-

¹ *McDowell v. Lindsey*, (1906) 213 Pa. 591, 63 A. 130.

² *Stern v. Mayer*, (1926) 166 Minn. 346, 207 N.W. 737; *Crichfield-Loeffler, Inc. v. Taverna*, (1926) (N.J.) 132 A. 494. An agreement to purchase stock "when issued" is not a subscription to stock to be issued, but a contract to purchase. *Clucas v. Bank of Montclair*, (1933) 110 N.J.L. 394, 166 A. 311.

³ *Burke v. Walker*, (1938) 124 N.J. Eq. 141, 200 A. 546. See also Frey, "Post-Incorporation Subscriptions," 77 U. PA. L. REV. 750-783.

⁴ *Stern v. Mayer*, *supra* (Note 2); *Stull v. Terry & Tench, Inc.*, (1948) 81 N.Y.S.(2d) 43.

livered or tendered the certificate to the purchaser, and the purchaser does not until then become liable as a stockholder.⁵

Subscriptions before incorporation. Subscriptions to the capital stock of a proposed corporation are obtained before the corporation is organized, for the following reasons: (1) to meet a statutory requirement that a certain amount of capital stock shall be subscribed before the corporation begins business; or (2) to assure the organizers of the corporation that the capital needed to finance the enterprise will be forthcoming.

Subscriptions obtained before incorporation will be valid and enforceable by the corporation thereafter formed only if there is an agreement between two or more parties to form such a corporation, and if the corporation is formed by such parties or by someone authorized to act for them in that regard.⁶ In order to be enforceable by the corporation, the agreement must have all the essentials of an ordinary contract (see page 815).

No formal agreement in writing or otherwise is necessary to constitute one a subscriber, unless the statute under which the corporation is to be organized, or the charter, calls for a certain form of agreement.⁷ Even when the manner of subscribing is regulated by statute, substantial compliance with the law will be sufficient.⁸ Thus, although the statute provides for the opening of subscription books, the use of

⁵ *Burke v. Walker*, *supra* (Note 3); *Barnard v. Tidrick*, (1915) 35 S.D. 403, 152 N.W. 690.

While the stock certificate is the authentic evidence of title to the stock, it is not necessary to the ownership of the stock. *Mau v. Montana Pac. Oil Co.*, (1928) 16 Del. Ch. 114, 141 A. 828; *Baker v. Bankers' Mortgage Co.*, (1927) 15 Del. Ch. 209, 135 A. 486.

⁶ *Sanders v. Barnaby*, (1915) 166 App. Div. 274, 151 N.Y. Supp. 580; *Jermyn v. Searing*, (1919) 225 N.Y. 525, 122 N.E. 706.

A corporation may maintain an action for a subscription made to its stock before it was formed, even though, because it was not yet in existence, it was not named as a promisee in the agreement to subscribe. *Ocala Community Hotel Co. v. Holloway*, (1931) 103 Fla. 521, 137 So. 882; *Perry Hotel Co. v. Courtney*, (1931) 102 Fla. 1041, 136 So. 691.

The date of signing the contract of subscription, whether before or after organization, is immaterial. If the corporation accepts the subscription and engages in the business for which it was created, the contract is completed. *Hatcher-Powers Shoe Co. v. Hitchens*, (1929) 232 Ky. 87, 22 S.W.(2d) 444.

No liability is incurred under a subscription contract unless the corporation thereafter formed is the specific corporation contemplated at the time of the subscription agreement. *Harlie R. Norris Co. v. Lovett*, (1932) 123 Cal. App. 640, 12 P.(2d) 141.

⁷ *Upton v. Tribilcock*, (1875) 91 U.S. 203; *Dingle v. Shaab*, (1941) 179 Md. 589, 20 A.(2d) 149; *Gibson v. Oswalt*, (1934) 269 Mich. 300, 257 N.W. 825; *Froug v. Miami Sav. & Loan Co.*, (1953) (Ohio App.) 128 N.E.(2d) 449; *Farrell v. Simons*, (1937) 180 Okla. 600, 71 P.(2d) 688.

⁸ See *Windsor Hotel Co. v. Schenk*, (1915) 76 W.Va. 1, 84 S.E. 911.

subscription paper instead of books does not make a subscription void.⁹ A binding contract can be made without actually signing a formal subscription paper or stock book, unless the statute or articles of incorporation provide to the contrary.¹⁰ The courts are governed by the intention of the parties; if the subscriber and the corporation clearly manifest their intention to enter into a contract whereby the relationship of stockholder of the corporation is to result, there will be a valid subscription.¹¹ A signature affixed to the articles of incorporation, as required by statute, with the number of shares placed opposite the signature, may constitute a subscription sufficiently valid to bind both the corporation and the subscriber.¹² The subscription, however, must be for a definite number of shares,¹³ and the amount that the subscriber is to pay for the shares must also be ascertainable. In actions on subscription agreements made before incorporation, the courts will generally apply the law of the state in which the contract was made, rather than the law of the state in which the corporation was organized.¹⁴

Conditions precedent to liability of subscriber on preorganization subscription. An agreement to subscribe for shares in a corporation to be formed is an executory contract. One of the conditions of such a contract is the formation of the corporation contemplated by the parties. The subscriber will be released from his obligation under the subscription contract: (1) if there is a material change in the charter of the corporation without his consent;¹⁵ or (2) if the corporation is not validly organized.¹⁶

⁹ *Nebraska Chicory Co. v. Lednický*, (1907) 79 Neb. 587, 113 N.W. 245.

¹⁰ *Walter v. Merced Academy Ass'n*, (1899) 126 Cal. 582, 59 P. 136.

¹¹ *Rutenbeck v. Huhn*, (1909) 143 Iowa 13, 121 N.W. 698.

¹² *Dupee v. Chicago Horse Shoe Co.*, (1902) 117 F. 40; *Zander v. Schuneman*, (1927) 170 Minn. 353, 212 N.W. 587.

¹³ *Wheeler v. Ocker & Ford Mfg. Co.*, (1910) 162 Mich. 204, 127 N.W. 332.

¹⁴ *Community Hotel Corp. v. Gilbert*, (1930) 135 N.Y. Misc. 676, 241 N.Y. Supp. 352.

¹⁵ The reason for the general rule is given in *Nugent v. The Supervisors of Putnam Co.*, (1873) 86 U.S. 83, as follows: "A subscription is always presumed to have been made in view of the main design of the corporation, and of the arrangements for its accomplishment. A radical change in the organization or purposes of the company may, therefore, take away the motive which induced the subscription, as well as affect injuriously the consideration of the contract. For this reason it is held that such a change exonerates a subscriber from liability for his subscription; or, if the contract has been executed, justifies the stockholder in resorting to a court of equity to restrain the company from applying the funds of the original organization to another project not contemplated by it." The general rule has no applicability to the case cited.

¹⁶ *Capps v. Hastings Prospecting Co.*, (1894) 40 Neb. 470, 58 N.W. 956; *Tonge v. Item Publishing Co.*, (1914) 244 Pa. 417, 91 A. 229.

In determining whether or not an alteration or change in the charter of the corporation is material and sufficient to release the subscriber, the facts in each case must be considered.¹⁷ In general, it may be said that, as long as the provisions of the charter conform to the main objects or purposes of the corporation contemplated at the time the subscription contract was made, the subscriber is not released by the alteration.¹⁸ But if the main objects or purposes of the corporation formed are different from those of the corporation proposed, then the subscriber will be released.¹⁹ If the amount of capital stock of the corporation formed is greater than the amount originally proposed, the change is material, and the subscriber is discharged.²⁰ A change in the capital stock structure has been held to be material and to release the subscriber.²¹

For the release of a subscriber upon his failure to make payment at the time of subscription, as required by the statute or charter, see page 827.

Withdrawal of preorganization subscription prior to acceptance by corporation. Subscriptions made before the formation of a corporation are usually of two kinds: (1) those in which an individual, acting alone and without the coöperation of others, offers to take stock in a corporation to be formed; or (2) those in which a number of persons agree to form a corporation and to subscribe to the capital stock. If the subscription is of the first type, the subscriber may rescind or revoke the subscription at any time before the corporation is formed and the subscription accepted. The reason for this is that it takes two parties to make a contract; if the corporation has not yet been formed, there is but one party, and, until the corporation is formed and the subscription accepted, there is no agreement, but a mere unaccepted offer.²² If the subscription is of

¹⁷ *National Bank of Union Point v. Amoss*, (1915) 144 Ga. 425 87 S.E. 406.

¹⁸ *Menominee Community Bldg. Co. v. Rueckert*, (1929) 245 Mich. 37, 222 N.W. 162. See also *Crawford v. Coleman Hotel Co.*, (1929) (Tex. Civ. App.) 16 S.W.(2d) 307.

¹⁹ *Bunn v. Farmers' Warehouse Co.*, (1916) 18 Ga. App. 567, 90 S.E. 78; *Owensboro Seating & Cabinet Co. v. Miller*, (1908) 130 Ky. 310, 113 S.W. 423.

²⁰ *Atlanta Steel Co. v. Maynahan*, (1912) 138 Ga. 668, 75 S.E. 980.

²¹ *Lane v. Coin Mach. Mfg. Co.*, (1918) 69 Pa. Super. 373; *Wallace v. Ducl*, (1934) 18 Tenn. App. 483, 79 S.W.(2d) 595.

²² *Collins v. Morgan Grain Co.*, (1926) 16 F.(2d) 253; *Moser v. Western Harness Racing Ass'n*, (1948) 89 Cal. App. (2d) 1, 200 P(2d) 7. See also *Wallace v. Ducl*, *supra* (Note 21); 76 U. PA. L. REV. 423.

the second type, the agreement, in some jurisdictions, constitutes a contract among the subscribers themselves.²³ It likewise constitutes a continuing offer to the proposed corporation. Upon acceptance, the subscription becomes a contract between each subscriber, respectively, and the corporation.²⁴ In many jurisdictions, such a subscription is not regarded as a contract among the subscribers themselves.²⁵ In states in which the subscription is regarded as a contract among the subscribers, none of the parties can withdraw without the acquiescence of all the subscribers, even before acceptance by the corporation.²⁶ According to the weight of authority, the subscription does not take effect as a contract with the corporation until the corporation is organized, and, since there is no contract, the signer of the subscription may withdraw.²⁷

Subscribers who desire to withdraw must give notice of their withdrawal. Such notice need not be in any particular form, nor need it be in writing or given at a meeting of the subscribers. If notice is given to the person who obtained the subscription or to the person who has charge of the subscription list, it is sufficient.²⁸

Acceptance of preorganization subscription by corporation. The final act that gives complete validity to a subscription procured prior to corporate organization is the acceptance of the subscription by the corporation after its formation.²⁹ No particular form of acceptance is

²³ *Collins v. Morgan Grain Co.*, supra (Note 22).

²⁴ *Ibid.* See also 26 GEO. L.J. 749.

²⁵ See *Macon Union Co-op. Ass'n v. Chance*, (1924) 31 Ga. App. 636, 122 S.E. 66 (citing *National Bank of Union Point v. Amoss*, supra (Note 17); *Allen & Co. v. Hastings Industrial Co.*, (1907) 2 Ga. App. 291, 58 S.E. 504, holding that "the preliminary agreement to form a corporation and take stock therein is not a contract by the subscribers with each other," and "is a mere offer to the corporation not yet in existence, and is revocable by any subscriber until the organization of the corporation, which operates as an acceptance of the offer." Since "all of the subscriptions are mere offers, the withdrawal of one offer will not affect the others."

²⁶ *Cravens v. Eagle Cotton Mills Co.*, (1889) 120 Ind. 6, 21 N.E. 981. See also *Crawford v. Coleman Hotel Co.*, supra (Note 18).

²⁷ *Hudson Real Estate Co. v. Tower*, (1892) 156 Mass. 82, 30 N.E. 465; *Bryant's Pond Steam Mill Co. v. Felt*, (1895) 87 Me. 234, 32 A. 888. See also 27 MICH. L. REV. 467; A. H. Frey, "Modern Development in the Law of Preincorporation Subscriptions," 79 U. PA. L. REV. 1005; "Release of Stock Subscriptions," 53 HARV. L. REV. 313, 321.

²⁸ *Planters & Merchants Independent Packing Co. v. Webb*, (1908) 156 Ala. 551, 46 So. 977; *Palais Du Costume v. Beach*, (1910) 144 Mo. App. 456, 129 S.W. 270.

²⁹ Acceptance of a contract by the corporation after incorporation is necessary to complete the contract, to constitute the subscriber a shareholder, and to fix his liability to pay for the stock. *Cramer v. Burnham*, (1928) 107 Conn. 216, 140 A. 477; *Jackson v.*

required: it may be express or implied, oral or written, and may depend upon acts as well as words. Recognition of the subscriber as a stockholder is sufficient to imply acceptance.³⁰ However, the statute or the charter may require acceptance in a particular way.

When the corporation accepts the charter granted in conformity with the purpose and powers as described in the subscription agreement,³¹ the subscription becomes binding, and the subscriber becomes a stockholder.³²

Subscriptions after incorporation. Some courts have held that there is a distinction between a subscription for stock in a corporation to be formed and a subscription for stock in a corporation already existent, so far as the status of the subscriber is concerned.³³ In the former case, the subscriber to the stock becomes a stockholder when the corporation is organized, whereas, in the latter, the subscription is considered a mere contract of purchase and sale between the subscriber and the corporation.³⁴ The general view, however, is that there is no distinction between a subscription to the stock of a corporation already organized and a subscription made prior to and for the purpose of organization.³⁵ So far as the subscription agreement is concerned, the general rule is that while a subscription before incorporation is governed by the law of the state in which the contract was made,³⁶ the validity of a subscription agreement after incorporation

Sabie, (1917) 36 N.D. 49, 161 N.W. 722; Glass Coating Co. v. Clark, (1928) 118 Ohio St. 10, 160 N.E. 460; Thielsen v. Linde, (1928) 127 Ore. 639, 271 P. 983; Martin v. Cushwa, (1920) 86 W. Va. 615, 104 S.E. 97; Natwick v. Terwilliger, (1916) 24 Wyo. 253, 160 P. 338.

For a discussion of what constitutes acceptance by the corporation, see A. H. Frey, "Modern Development in the Law of Preincorporation Subscriptions," 79 U. PA. L. REV. 1005.

³⁰ Nebraska Chicory Co. v. Lednicky, *supra* (Note 9).

³¹ Crawford v. Coleman Hotel Co., *supra* (Note 18); Menominee Community Bldg. Co. v. Rueckert, *supra* (Note 18).

³² Baltimore City Passenger Ry. v. Hambleton, (1893) 77 Md. 341, 26 A. 279.

³³ Baltimore City Passenger Ry. v. Hambleton, *supra* (Note 32); Schwartz v. Manufacturers' Cas. Ins. Co., (1939) 335 Pa. 130, 6 A.(2d) 299. But see Penn-Allen Broadcasting Co. v. Traylor, (1957) 389 Pa. 490, 133 A.(2d) 528, in which the court held that all distinctions between pre- and post-incorporation subscriptions had been abolished by an earlier statute and that Schwartz was overruled.

³⁴ Reagan v. Midland Packing Co., (1924) 298 F. 500; Stern v. Mayer, *supra* (Note 2); Crichfield-Loeffler, Inc. v. Taverna, *supra* (Note 2).

³⁵ "All those who join in the enterprise of accumulating the capital of the corporation, represented by subscriptions to the original issue of capital stock, should be regarded as subscribers, rather than as purchasers, whether the agreement is made before or after the articles are filed." Reagan v. Midland Packing Co., *supra* (Note 34).

³⁶ See page 811.

is controlled by the laws of the state in which the corporation was organized.³⁷

Elements necessary for validity and enforcement of subscription.

Upon acceptance of subscriptions to its capital stock, a corporation can enforce each subscription agreement, provided that such agreement is a valid and enforceable contract³⁸ under the law of the state of incorporation.³⁹ To be valid and enforceable, a capital stock subscription contract must contain the following elements:

1. *Competent parties.* Legal competency to make a contract is sufficient to qualify an individual to enter into a stock subscription contract, unless the statute under which the corporation is organized, or its charter, expressly or impliedly, provides otherwise.⁴⁰ Special care should be taken in accepting subscriptions from aliens. (In regard to the power of a corporation to subscribe to stock of other corporations, see page 202.)

2. *Valid consideration.* To be enforceable, the subscription must be supported by a valid consideration. Inasmuch as mutual promises are adequate consideration to support ordinary contracts, the subscriber's promise to take and pay for the stock is sufficient consideration for the corporation's promise to issue the stock upon payment.⁴¹

3. *Offer and acceptance.* This element of a valid contract is supplied by the subscriber's offer to take the shares and the corporation's acceptance of the subscription. If the subscriber revokes or rescinds his offer before it is accepted by the corporation, his obligation is at an end. If the corporation, while solvent, refuses to receive payment

³⁷ May v. Roberts, (1930) 133 Ore. 643, 286 P. 546; McAlister v. Eclipse Oil Co., (1935) (Tex. Civ. App.) 79 S.W.(2d) 895. See also Thomas v. Kalbtus, (1918) 97 Ohio St. 232, 119 N.E. 412.

³⁸ Where the subscription agreement for capital stock of a corporation was not accompanied by payment and delivery of the certificate of stock, the court held that it was an executory contract. Steele v. Singletary, (1922) 120 S.C. 132, 110 S.E. 833. To the same effect, see Kappers v. Cast Stone Constr. Co., (1924) 184 Wis. 627, 200 N.W. 376. However, in Jackson v. Sabie, supra (Note 29), the court said: "In the absence of regulations to the contrary, the principles which govern the formation of an ordinary contract apply with full force to a contract of subscription to corporate stock." See Farm Lands Development Co. v. Taft, (1922) 194 Iowa 481, 186 N.W. 431; Thomas v. Scoutt, (1927) 115 Neb. 848, 215 N.W. 140.

³⁹ Collins v. Morgan Grain Co., supra (Note 22).

⁴⁰ Cattlemen's Trust Co. v. Turner, (1916) (Tex. Civ. App.) 182 S.W. 438.

⁴¹ Scranton Axle & Spring Co. v. Scranton Board of Trade, (1921) 271 Pa. 6, 113 A. 838.

tendered by the subscriber, he may avail himself of the corporation's refusal and withdraw his offer, and he is exonerated from his obligation on the subscription even if the corporation subsequently becomes insolvent.⁴²

4. *Meeting of the minds.* As in other contracts, there must be a meeting of the minds of the parties to the stock subscription contract. A mutual mistake concerning a material fact may be sufficient to justify the subscriber in rescinding his subscription.⁴³

5. *Legality of the contract.* The contract must not be illegal. If the purpose for which the corporation was formed is illegal, the stock subscription contract will be illegal.⁴⁴ If the contract violates some statute, it will also be illegal.⁴⁵ Thus, if the contract fixes the price of the stock at less than par value and a statute requires par value to be paid for all shares, the contract is not legal.⁴⁶ Contracts calling for stock to be issued in excess of authorized amounts are also illegal.⁴⁷

6. *Freedom from fraud.* The stock subscription contract must not be tainted by fraud. If the subscriptions are obtained by fraudulent misrepresentations, under duress, or by means of the exercise of undue influence, they may be avoided by the subscribers.⁴⁸

What constitutes fraud sufficient to invalidate subscription. The existence or nonexistence of fraud sufficient to invalidate⁴⁹ a stock subscription contract depends to so great an extent upon the facts in each particular case, that the courts have found it impossible or inexpedient to lay down definite rules as to what does or does not constitute fraud.⁵⁰ In general, it may be said that in order to constitute

⁴² Potts v. Wallace, (1892) 146 U.S. 689, 13 S. Ct. 196.

⁴³ Moseley v. Red River Oil Mill, (1927) 6 La. App. 725; Hill v. International Products Co., (1925) 129 N.Y. Misc. 25, 220 N.Y. Supp. 711.

⁴⁴ Le Warne v. Meyer, (1889) 38 Fed. 191; Clemshire v. Boone County Bank, (1890) 53 Ark. 512, 14 S.W. 901.

⁴⁵ Castle v. Acme Ice Cream Co., (1929) 101 Cal. App. 94, 281 P. 396.

⁴⁶ Tramp v. Marquesen, (1920) 188 Iowa 968, 176 N.W. 977.

⁴⁷ Crawford v. Twin City Oil Co., (1927) 216 Ala. 216, 113 So. 61; World Oil Co. v. Hicks, (1929) (Tex. Civ. App.) 19 S.W.(2d) 605.

⁴⁸ Bohn v. Burton-Lingo Co., (1915) (Tex. Civ. App.) 175 S.W. 173.

⁴⁹ See Note 62, *infra*.

⁵⁰ Rescission for fraud applies only to stock subscription contracts which are executed in whole or in part by the fraudulent party, and not to those which are merely executory. Gould v. Bester, (1928) 127 Ore. 308, 271 P. 988.

fraud sufficient to invalidate a stock subscription contract, the following elements must be present:⁵¹

1. A false representation⁵² must be made as to a past or present fact that is material to the subscription contract.⁵³
2. The false representation must be made by an authorized agent of the corporation to the subscriber.⁵⁴
3. The statement must be false.⁵⁵
4. The party making the statement must know that it is false,⁵⁶ or must have made it recklessly, with no knowledge of its truth, and as a positive assertion.⁵⁷

⁵¹ Bohn v. Burton-Lingo Co., *supra* (Note 48). See also Kentucky Elec. Development Co.'s Receiver v. Head, (1934) 252 Ky. 656, 68 S.W.(2d) 1; Berwick Hotel Co. v. Vaughan, (1930) 300 Pa. 389, 150 A. 613; Goodin v. Palace Store Co., (1931) 164 Wash. 625, 4 P.(2d) 493.

⁵² A distinction is made between statements relative to the prospects and capabilities of the enterprise and statements representing facts which do not exist. The former are matters of opinion merely and do not constitute grounds for annulling the contract. The latter are material representations which are fraudulent and hence constitute grounds for annulment. For example, a statement made by a representative of a corporation, in order to procure a subscription to stock, that the company was actually engaged in manufacturing the product which it was organized to manufacture, when, as a matter of fact, it was not so engaged, was a misrepresentation of a material fact. On the other hand, a statement that the stock would pay annually a dividend of nine per cent was merely a promise and not a misrepresentation of a material fact. Steele v. Singletary, *supra* (Note 38). A representation as to the amount of capital stock subscribed or paid in is a representation of a material matter. Fuhrman v. American Nat'l Bldg. & Loan Ass'n, (1932) 126 Cal. App. 202, 14 P.(2d) 601. A subscriber for stock is not bound to investigate the truth of statements upon the strength of which he subscribes. American Alkali Co. v. Salom, (1904) 131 F. 46; Griffin v. Burrus, (1927) (Tex. Civ. App.) 292 S.W. 561.

⁵³ Under the federal Securities Act of 1933, as amended, any person who sells a security through the channels of interstate commerce or through the mails, by means of a prospectus or oral communication which either includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading, is liable to the purchaser of the security. See Prentice-Hall *Securities Regulation* for complete information on this Act.

⁵⁴ Seacoast Packing Co. v. Long, (1921) 116 S.C. 406, 108 S.E. 159. See also Fuhrman v. American Nat'l Bldg. & Loan Ass'n, *supra* (Note 52).

⁵⁵ Denis v. Nu-Way Puncture-Cure Co., (1919) 170 Wis. 333, 175 N.W. 95.

⁵⁶ Peake v. Thomas, (1927) 222 Ky. 405, 300 S.W. 885; Guynn v. Shulters, (1955) 223 Miss. 232, 78 So. (2d) 114.

⁵⁷ Kentucky Elec. Development Co.'s Receiver v. Head, *supra* (Note 51). See West Texas Util. Co. v. Ellis, (1937) (Tex. Civ. App.) 102 S.W.(2d) 234. This case holds that it is immaterial whether the false representations were made in good faith or not.

5. The misrepresentation must be intended to induce the subscriber to act upon it.⁵⁸

6. The acts of the subscriber must show that he relied upon the representations.⁵⁹ (The signature of the subscriber to the subscription agreement, in the absence of evidence to the contrary, is proof that he relied upon the representations and acted on the faith of them.⁶⁰)

7. The subscriber must have suffered injury thereby.⁶¹

Remedies of subscriber in case of fraud. A contract procured by fraud is not void, but it is voidable only at the option of the party defrauded, which means that it is valid until disaffirmed.⁶² In most states, several remedies are possible for a subscriber induced by fraud to subscribe for stock of a corporation. (1) He may rescind the subscription by notifying the corporate authorities without taking legal proceedings.⁶³ If he rescinds the contract, he must surrender, or at least tender, what he received under the contract,⁶⁴ unless it was wholly executory on the part of the wrongdoer.⁶⁵ (2) He may repudiate the subscription and bring an action in equity to have the subscription canceled, thus assuring himself of relief from all liability as a stockholder.⁶⁶ (3) If the corporation brings an action against the subscriber to enforce the payment of the subscription price, or an assessment on the shares, the subscriber may defend the action

⁵⁸ Equity Co-op Ass'n v. Equity Co-op Milling Co., (1922) 63 Mont. 26, 206 P. 349.

⁵⁹ The subscriber must be justified in relying on the statements made. See Chandler v. McKerral, (1934) 68 F.(2d) 343. A subscriber to stock must exercise a reasonable degree of care to avoid being misled. Hines v. Saart Bros. Co., (1931) 51 R.I. 436, 155 A. 533.

A person subscribing for capital stock in a corporation is justified in relying on representations concerning existing facts when knowledge of such facts is neither possessed by him nor available to him, but is possessed by the party making the representations. Fuhrman v. American Nat'l Bldg. & Loan Ass'n, supra (Note 52).

False representations concerning the value of stock, when the purchaser has an opportunity to ascertain the value for himself, do not authorize rescission. Kentucky Elec. Development Co.'s Receiver v. Head, supra (Note 51).

⁶⁰ American Alkali Co. v. Salom, supra (Note 52).

⁶¹ Peake v. Thomas, supra (Note 56).

⁶² Upton v. Englehart, (1874) 3 Dill. (U.S.) 496; Akers v. Radford State Bank, (1929) 153 Va. 1, 149 S.E. 528.

⁶³ Kentucky Elec. Development Co.'s Receiver v. Head, supra (Note 51); McGrath v. C. T. Sherer Co., (1935) 291 Mass. 35, 195 N.E. 913; Bohn v. Burton-Lingo Co., supra (Note 48).

⁶⁴ Kentucky Elec. Development Co.'s Receiver v. Head, supra (Note 51).

⁶⁵ Roberts v. James, (1912) 83 N.J.L. 492, 85 A. 244; Gould v. Bester, supra (Note 50).

⁶⁶ Tyler v. Savage, (1892) 143 U.S. 79, 12 S. Ct. 340.

brought against him, setting forth fraud as a defense.⁶⁷ (4) If the subscriber has paid any money to the corporation on the subscription, he may bring an action at law to recover what he has paid.⁶⁸ (5) He may affirm the contract and sue for damages.⁶⁹ The rescission of a subscription contract because of fraud must be made promptly upon discovery of the fraud.⁷⁰ Moreover, the subscriber must exercise diligence in discovering the fraud.⁷¹ If the subscriber performs any material act, such as attending meetings of stockholders, signing a proxy,⁷² accepting dividends, or taking an active part in the management of the corporation, with knowledge of the facts constituting the fraud, or under such circumstances that knowledge must be imputed, he will be held to have waived the fraud and ratified the subscription contract.⁷³

The remedies mentioned above may be invoked while the corporation is solvent. If the corporation becomes insolvent, and the rights of creditors are involved, the opportunity to rescind the subscription, even though it has been procured through fraud, may be denied.⁷⁴ No definite rule applicable to every jurisdiction in this country can be stated regarding the effect of corporate insolvency upon the right of a subscriber to rescind his contract on the ground of fraud. However, in a leading case, the court said:

The decisions of the courts, we think, sustain the doctrine laid down in the textbooks, that a person who has to all external appearances become a stockholder cannot, as to creditors who may have trusted the company

⁶⁷ *American Alkali Co. v. Salom*, supra (Note 52); *Davis v. Gifford*, (1918) 182 App. Div. 99, 169 N.Y. Supp. 492.

⁶⁸ *Davis v. Gifford*, supra (Note 67); *Hunsicker v. Gilham*, (1927) 163 La. 651, 112 So. 518.

⁶⁹ *Fulmele v. Los Angeles Inv. Co.*, (1921) 51 Cal. App. 417, 196 P. 923; *Davis v. Gifford*, supra (Note 67).

⁷⁰ *Fulmele v. Los Angeles Inv. Co.*, supra (Note 69); *Davis v. Gifford*, supra (Note 67); *Wilson v. Empire Holding Corp.*, (1934) 145 Ore. 598, 28 P.(2d) 843; *Coyle v. Franklin State Bank*, (1934) 213 Wis. 601, 252 N.W. 361.

⁷¹ *Upton v. Tribilcock*, supra (Note 7); *Gannon v. Grayson Water Co.*, (1934) 254 Ky. 251, 71 S.W.(2d) 433. See also *Trinity Universal Ins. Co. v. Maxwell*, (1937) (Tex. Civ. App.) 101 S.W.(2d) 606.

⁷² See, however, *Wilson v. Empire Holding Corp.*, supra (Note 70), in which it was held that the giving of a proxy was not an affirmation of a contract, where the buyer had given notice of intention to rescind the contract.

⁷³ *Fulmele v. Los Angeles Inv. Co.*, supra (Note 69); *In re Marcella Cotton Mills*, (1925) 8 F.(2d) 522.

⁷⁴ *Willentz v. Hickox Finance Corp.*, (1939) 125 N.J. Eq. 28, 4 A.(2d) 1229.

upon the faith of his membership, have his contract of subscription rescinded upon the ground of fraud, where he did not repudiate the contract, and cannot take steps to have it rescinded before the company stopped payments and became actually insolvent. . . .⁷⁵

The attempt to avoid the status of stockholder after a corporation has become bankrupt is looked upon with suspicion. A federal court has held that the right to rescind should be denied under any of the following circumstances:⁷⁶ (1) if a considerable period of time has elapsed since the subscription was made; (2) if the subscriber has actively participated in the management of the corporation; (3) if there has been any want of diligence on the part of the stockholder either in discovering the alleged fraud or in taking steps to rescind the subscription when the fraud was discovered; or, (4) above all, if any considerable amount of corporate indebtedness has been created since the subscription was made.

Release of subscriber from subscription contract—consent of stockholders. A corporation,⁷⁷ for a valuable consideration,⁷⁸ may release a subscriber from his subscription contract only under the following circumstances: (1) upon consent of all the stockholders to the release;⁷⁹ or (2) upon authorization by the board of directors, if the statute, charter, or by-laws of the corporation confer upon the directors the power to release the subscriber without the consent of all the stockholders.⁸⁰ Consent of the stockholders may be implied from their acquiescence.⁸¹

No particular formalities are required to effect the release.⁸² It is

⁷⁵ *Martin v. South Salem Land Co.*, (1896) 94 Va. 28, 26 S.E. 591.

⁷⁶ *In re Marcella Cotton Mills*, supra (Note 73); *Newton Nat'l Bank v. Newbegin*, (1896) 74 Fed. 135.

⁷⁷ In *Haebler v. Crawford*, (1931) 232 App. Div. 122, 249 N.Y. Supp. 184, it was held that evidence of a secret release to defeat the liability of a subscriber was proof of fraud upon the creditors and stockholders of the corporation.

⁷⁸ A release, like any other contract, must be supported by valuable consideration. *W. H. Stenners Co. v. Lake Worth Realty & Bldg. Co.*, (1930) 45 F.(2d) 297, cert. denied, 283 U.S. 833, 51 S. Ct. 366; *Zirkel v. Joliet Opera House Co.*, (1875) 79 Ill. 334; *United Growers Co. v. Eisner*, (1879) 22 App. Div. 1, 47 N.Y. Supp. 906.

⁷⁹ *American Nat'l Bank v. Tinsley Millinery Co.*, (1936) 20 Tenn. App. 459, 100 S.W. (2d) 665; *Marcuse v. Broad-Grace Arcade Corp.*, (1935) 164 Va. 553, 180 S.E. 327. See also 53 HARV. L. REV. 313.

⁸⁰ *Thomas v. Wentworth Hotel Co.*, (1911) 16 Cal. App. 403, 117 P. 1041.

⁸¹ *Silica Brick Co. v. Winsor*, (1915) 171 Cal. 18, 151 P. 425.

⁸² In *Inter-Mountain Ass'n v. Davies*, (1923) 61 Utah 461, 214 P. 307, the court said: "A release of a subscription need not be express or formal; it may be shown by parol or

advisable, however, to obtain the necessary consent to the release at a meeting properly called, and to enter in the minutes the resolution of the stockholders or directors authorizing the release of a subscriber from the obligation of all or a part of his subscription contract.

Release of subscriber from subscription contract—rights of creditors. A release of a subscriber from a subscription contract is ineffective against existing creditors if their rights are involved, even if all the stockholders consent to the release, and the directors act with proper authority.⁸³ No definite rule can be laid down regarding the effect, on the rights of subsequent creditors, of a release by the corporation of a subscriber's subscription, because the courts differ in their rulings, some courts holding that the release is valid as to existing creditors only, and others holding it invalid as to both existing and subsequent creditors.⁸⁴

The reason for holding a release invalid as against creditors is generally found in the doctrine known as the "trust fund" theory. This doctrine views the subscribed capital stock of a corporation, both paid and unpaid, as a trust fund which shall not be reduced, diminished, or impaired except with the consent of the stockholders and creditors.⁸⁵ Under the trust fund theory, the creditor is presumed to have given credit on the assumption that the working capital of the corporation, whether actually paid in or promised to be paid in, will be kept available to satisfy his debts.⁸⁶ The release of a subscriber from the obligation of his unpaid subscription would have the effect of reducing the fund upon which the creditor depends for the pay-

circumstantial evidence; and it is sufficient if the subscription is deemed abandoned by mutual consent."

⁸³ *Myers v. C. W. Toles & Co.*, (1939) 287 Mich. 340, 283 N.W. 603.

⁸⁴ In *Shoemaker v. Washburn Lumber Co.*, (1897) 97 Wis. 585, 73 N.W. 333, it was held that a solvent corporation has a right by the unanimous vote of its stockholders, to cancel stock subscribed but not paid for, and a subsequent corporate creditor is not prejudiced by such action, while in *Christman-Sawyer Banking Co. v. Independence Wool Mfg. Co.*, (1902) 168 Mo. 634, 68 S.W. 1026, in an able and exhaustive opinion in which many cases pro and con are cited on this point, it was held that unpaid stock subscriptions were "an asset of an incorporated company, which all creditors, without regard to when their debts were contracted, have a right to look to, and which cannot be exhausted, released, given away, wiped out, or impaired by any act of the corporation or the stockholder to the injury of the creditor, except by his consent."

⁸⁵ *Thomas v. Wentworth Hotel Co.*, *supra* (Note 80); *Bartelt v. Lehman*, (1947) (Tex. Civ. App.) 207 S.W.(2d) 131.

⁸⁶ *Silica Brick Co. v. Winsor*, *supra* (Note 81).

ment of his debt; hence any such release without the consent of creditors is regarded as a fraud upon the creditors of the company.⁸⁷

Compromise release. Under certain circumstances, it is permissible for the board of directors of a solvent corporation, without the consent of the stockholders, to enter into a compromise agreement with subscribers, releasing them from their liability and accepting the surrender of the shares agreed to be taken. Thus, directors acting in good faith may make a compromise with subscribers who are insolvent, or who are of doubtful financial responsibility.⁸⁸ Such a release, while valid against subsequent creditors, would not be valid so far as the rights of existing creditors are concerned.⁸⁹ The board of directors of a solvent corporation has the power, as against stockholders and creditors, to compromise a bona fide dispute as to the amount due upon an unpaid subscription, and payment of a certain sum in satisfaction of the entire debt will relieve the subscriber from a claim for unpaid subscription.⁹⁰

Power of corporation to accept conditional subscriptions. Capital stock subscription contracts, like other contracts, may be made upon conditions either precedent or subsequent; in general, the same principles and rules of law are applicable to conditional subscriptions as to other conditional contracts.⁹¹ (For an explanation of conditions precedent, see the next paragraph; for conditions subsequent, see page 825.)

Unless prohibited by statute from accepting conditional subscriptions, a corporation may receive conditional subscriptions to its capital stock at any time after incorporation.⁹² Subscriptions taken prior to organization of the corporation may or may not be made conditional, depending upon the statute and the attitude of the courts of the state in which the corporation is organized, toward conditional subscriptions. In some jurisdictions, if a condition is attached to a

⁸⁷ *Burke v. Smith*, (1872) 83 U.S. 390.

⁸⁸ *New Albany v. Burke*, (1870) 78 U.S. 96; *Thomas v. Wentworth Hotel Co.*, *supra* (Note 80). See also 53 HARV. L. REV. 313.

⁸⁹ *Thomas v. Wentworth Hotel Co.*, *supra* (Note 80).

⁹⁰ *New Haven Trust Co. v. Nelson*, (1901) 73 Conn. 477, 47 A. 753; *Elliott v. Ashby*, (1905) 104 Va. 716, 52 S.E. 383.

⁹¹ *Nowlin v. Memphis Packing Corp.*, (1923) 161 Ark. 294, 255 S.W. 1092.

⁹² *Armstrong v. Karshner*, (1890) 47 Ohio St. 276, 24 N.E. 897; *Talbot v. Chattanooga Automobile Identification Underwriters*, (1931) 163 Tenn. 256, 43 S.W.(2d) 220.

subscription taken before organization of the corporation, the subscription is void;⁹³ in others, the subscription is binding in spite of the condition, but the condition is void.⁹⁴ If the law under which the corporation is organized requires that a certain amount of the stock shall be subscribed before the corporate powers may be exercised, the subscriptions obtained prior to the organization of the corporation and for the purpose of organization must be absolute and unconditional.⁹⁵

Subscriptions on conditions precedent. A subscription on a condition precedent means that some condition is set up in the subscription agreement that must be performed by the corporation before the subscription will be binding or effectual.⁹⁶ Capital stock subscription contracts may be made upon any expressed conditions precedent that the parties desire, so long as there is no provision in the statute, charter, or by-laws to the contrary. For example, it may be stipulated in the contract that a note given in payment for stock shall become due and payable if subscription and payment have been made for a certain number of shares. Performance of this condition precedent by the corporation is necessary before the corporation can recover on the subscription.⁹⁷

Any subscription, whether before or after incorporation, is subject to the following implied conditions precedent: (1) the corporation must have the power to issue the stock subscribed for;⁹⁸ and (2) all or a particular part of the capital stock must be subscribed in accordance with the governing statute, charter, or by-laws.⁹⁹ Neither

⁹³ *Berger v. Callender*, (1936) 81 F.(2d) 687.

⁹⁴ *People v. Chambers*, (1871) 42 Cal. 201.

⁹⁵ *Burke v. Smith*, *supra* (Note 87).

⁹⁶ *Felton v. Highlands Hotel Co.*, (1928) 165 Ga. 598, 141 S.E. 793; *National Bank of the Republic v. Beckstead*, (1926) 68 Utah 421, 250 P. 1033; "Conditional Share Subscriptions," 37 *YALE L.J.* 226.

⁹⁷ *Nowlin v. Memphis Packing Corp.*, *supra* (Note 91). See also *Metzler Bros. v. Johnson*, (1931) (Tex. Civ. App.) 45 S.W.(2d) 263, in which it was held that where a purchase of stock was conditional, and the conditions were never complied with, the purchaser could recover the amount paid therefor unless he had waived the conditions.

⁹⁸ *Clark v. Millsap*, (1926) 197 Cal. 765, 242 P. 918; *Marion Trust Co. v. Bennett*, (1907) 169 Ind. 246, 82 N.E. 782.

⁹⁹ The reason for this rule is that the subscriber in effect agrees to become the owner of an interest in the corporation which bears a fixed relationship to the total number of shares authorized, and he has a right to assume that the corporation will refrain from commencing business until all of its proposed capital stock has been subscribed. *Poultry*

payment on the subscription nor issuance or tender of a stock certificate¹⁰⁰ is an implied condition precedent to a stock subscription contract.¹⁰¹

Release of subscriber upon corporation's failure to perform conditions precedent. Until conditions precedent are performed by the corporation, the subscriber does not become a stockholder of the company.¹⁰² Upon performance of conditions precedent by the corporation, the subscription becomes absolute, payable according to its terms,¹⁰³ and the subscriber becomes a stockholder of the company, entitled to all the rights and privileges, and subject to all the liabilities, of a stockholder.¹⁰⁴

Failure of the corporation to perform conditions precedent within the time stated in the subscription contract, or, if no time is stated, then within a reasonable time, will release the subscriber from his subscription,¹⁰⁵ unless waiver or estoppel operates to prevent the subscriber from setting up the corporation's nonperformance as a defense.¹⁰⁶

Unless the subscription contract requires it, the corporation need not give the subscriber notice of the performance of the condition;

Producers v. Nilsson, (1925) 197 Cal. 245, 239 P. 1086; *Huxtable v. Shumate*, (1922) 79 Ind. App. 293, 134 N.E. 896.

The general rule that all the capital stock must be subscribed as a condition precedent to liability does not apply: (1) Where the statute sanctioned corporate organization upon subscription of less than the authorized capital stock; where the stockholder either expressly or impliedly waives the condition. *Huxtable v. Shumate*, *supra*, *Morgan v. Laudstreet*, (1909) 109 Md. 558, 72 A. 399. (2) Where the subscriber did not contemplate that any definite amount of stock would be subscribed before he became bound. *Mountain View Development Co. v. Burnett*, (1932) 164 Tenn. 210, 46 S.W.(2d) 809.

¹⁰⁰ *Dickinson County Hospital Co. v. Kessinger*, (1929) 128 Kan. 576, 279 P. 7; *Atlantic Transp. Co. v. Alexander Shipping Co.*, (1927) 261 Mass. 1, 157 N.E. 725; *National Bank of the Republic v. Beckstead*, *supra* (Note 96).

¹⁰¹ *Nicholson-Watson Shoe & Clothing Co. v. Urquhart*, (1903) 32 Tex. Civ. App. 527, 75 S.W. 45. See also *First Nat'l Bank v. Morgan*, (1930) 132 Ore. 515, 286 P. 558.

¹⁰² *Webb v. Baltimore & E. S. R.R.*, (1893) 77 Md. 92, 26 A. 113.

¹⁰³ *Martin v. Steinke*, (1926) 22 Ohio App. 146, 154 N.E. 47.

¹⁰⁴ *Cravens v. Eagle Cotton Mills Co.*, *supra* (Note 26).

¹⁰⁵ *Natwick v. Terwilliger*, (1916) 24 Wyo. 253, 157 P. 696, 160 P. 338. A subscription contract entitling the subscriber to stock certificates "when, as and if issued," was held to be a conditional subscription, entitling the subscriber to a return of his money on failure of the corporation to issue the certificates within a reasonable time. *Bahr v. Breeze Corp.*, (1939) 126 N.J. Eq. 124, 8 A.(2d) 185, *aff'd* (1940) 127 N.J. Eq. 257, 12 A.(2d) 678. Recovery was barred in this case because of the statute of limitations.

¹⁰⁶ *Johnson v. Boadway Bros.*, (1928) 90 Cal. App. 260, 265 P. 855; *Shiffer v. Akenbrook*, (1921) 75 Ind. App. 149, 130 N.E. 241; *Thielsen v. Linde*, (1928) 127 Ore. 639, 271 P. 983.

however, notice must be given if the fact of performance is peculiarly within the knowledge of the corporation.¹⁰⁷

Withdrawal by subscriber from subscription upon conditions precedent. In some states, the courts hold that capital stock subscriptions upon conditions precedent are effective not as contracts but as continuing offers, which may develop into contracts upon the corporation's performance of the conditions; since they are mere offers, however, they may be withdrawn by the subscribers prior to acceptance of the offer by performance of the conditions precedent.¹⁰⁸

Other jurisdictions view capital stock subscription contracts upon conditions precedent as binding and deny subscribers the right to withdraw, even before performance of the conditions.¹⁰⁹ As indicated above,¹¹⁰ in states that hold that a subscription is a contract between the subscribers, there can be no withdrawal without the acquiescence of all the subscribers.¹¹¹

Subscriptions upon conditions subsequent. Under a capital stock subscription contract upon conditions subsequent, a binding agreement between the corporation and the subscriber becomes effective at the time the subscription contract is made.¹¹² Coupled with the subscription contract, however, is a collateral agreement on the part of the corporation that it will perform a certain act.¹¹³ For example, a subscriber agrees to take stock, and the corporation agrees to maintain its plant at a certain place for a fixed period,¹¹⁴ or to establish a depot at a fixed location.¹¹⁵ A subscription made on special terms, such as

¹⁰⁷ An example of a fact peculiarly within the knowledge of the corporation is found in *Chase v. Sycamore & C. R.R.*, (1865) 38 Ill. 215, where the subscription contract was made upon condition that the corporation raise a specified sum of money for the purchase of particular equipment.

¹⁰⁸ *Webb v. Baltimore & E. S. R.R.*, supra (Note 102); *Armstrong v. Karshner*, supra (Note 92).

¹⁰⁹ *Cravens v. Eagle Cotton Mills Co.*, supra (Note 26). *Philadelphia, etc., R.R. v. Hickman*, (1857) 28 Pa. St. 318.

¹¹⁰ See page 813.

¹¹¹ *Cravens v. Eagle Cotton Mills Co.*, supra (Note 26). See also *Farm Lands Development Co. v. Taft*, supra (Note 38).

¹¹² *Bryan v. St. Andrews Bay Community Hotel Corp.*, (1930) 99 Fla. 132, 126 So. 142; *Appeal of Cornell*, (1886) 114 Pa. St. 153, 6 A. 258; *Morrow v. Nashville Iron & Steel Co.*, (1889) 87 Tenn. 262, 10 S.W. 495.

¹¹³ *Schwab v. Getty*, (1927) 145 Wash. 66, 258 P. 1035.

¹¹⁴ *Bryan v. St. Andrews Bay Community Hotel Corp.*, supra (Note 112); *Bobzin v. Gould Balance Valve Co.*, (1909) 140 Iowa 744, 118 N.W. 40.

¹¹⁵ *Paducah & M. R.R. v. Parks*, (1888) 86 Tenn. 554, 8 S.W. 842.

a special mode of payment for the stock, is sometimes said to be a subscription upon conditions subsequent.¹¹⁶

A corporation may accept subscriptions upon conditions subsequent or under special terms, provided that: (1) the conditions or terms do not constitute a fraud upon other stockholders or subscribers, or upon the creditors of the corporation; and (2) the conditions and terms are not prohibited by law or limited by the charter of the corporation.¹¹⁷

Effect of corporation's failure to perform conditions subsequent.

Under a subscription contract on conditions subsequent, the subscriber becomes a stockholder at the time the contract is made. Ordinarily, if the corporation fails to perform a condition subsequent or to comply with special terms of the subscription contract, the stockholder is nevertheless liable for the amount of his subscription, and his only remedy is a right of action against the corporation for any damage he may have sustained.¹¹⁸ However, if the corporation's breach of the contract amounts to a failure of the consideration for the contract, the subscriber may be discharged from the subscription, except so far as creditors are concerned.¹¹⁹ Thus, it has been held that if the contract of subscription to stock of a railroad company fixes the points at which the railroad shall begin and end and indicates the route, the abandonment of either terminus or any material part of the road as set forth in the contract, constitutes a failure of consideration, and the subscriber is released from his obligation.¹²⁰

¹¹⁶ *Nippenose Mfg. Co. v. Stadon*, (1871) 68 Pa. St. 256, which held that, after its organization, a corporation may agree with its subscribers as to payment for their stock upon any special terms acceptable to both parties; thereafter, the company is precluded from enforcing the subscription in any other manner. See 22 MINN. L. REV. 731 (1938).

¹¹⁷ *Spratling v. Westbrook*, (1913) 140 Ga. 625, 79 S.E. 536; *Talbot v. Chattanooga Automobile Identification Underwriters, Inc.*, supra (Note 92). See also *O'Dell v. Appalachian Hotel Corp.*, (1929) 153 Va. 283, 149 S.E. 487.

¹¹⁸ *Bryan v. St. Andrews Bay Community Hotel Corp.*, supra (Note 112); *Bobzin v. Gould Balance Valve Co.*, supra (Note 114). But see *Patterson v. U.S. Bond & Mortgage Co.*, (1940) 240 Ala. 474, 199 So. 695. In this case, the assignee of the subscriber became entitled to a refund of payments made by the subscriber because the corporation had not lived up to the special terms of the subscription agreement. These terms gave the corporation the right to cancel the subscription if payments were not made as called for, offer the shares for resale, and refund payments made by the subscriber less certain costs. The corporation had not used reasonable diligence in trying to resell the stock.

¹¹⁹ *Seymour v. Detroit Copper & Brass Rolling Mills*, (1885) 56 Mich. 117, 22 N.W. 317, 23 N.W. 186.

¹²⁰ *Caley v. Phila. & Chester Co. Ry.*, (1876) 80 Pa. St. 363.

Payment at time of subscription. In the absence of charter or statutory requirements, neither all nor any particular part of the subscription price of stock need be paid in at the time of the subscription, but payment may be called for by the directors as the money is needed.¹²¹ At one time, the corporation laws of many states provided that subscriptions must be accompanied by a cash payment of at least a specified percentage of the face amount of the subscription. Many of these statutes have in recent years been repealed. The courts that were called upon to interpret the effect of non-payment of the specified amount of cash laid down these general principles:

1. If the subscription is made after incorporation, the failure to pay the required amount at the time of subscribing will not entitle the subscriber to release from his liability on the subscription, unless the statute or charter expressly provides that a subscription unaccompanied by the required payment shall be void.¹²²

2. On subscriptions made before incorporation, the release from liability because of the failure of the subscriber to pay the amount on his subscription required by statute or charter, depends upon whether or not it is the intention of the statute that payment with the subscription shall constitute a condition precedent to incorporation. If the statute indicates that payment is a condition precedent to incorporation, failure to pay the required amount will release the subscriber from liability, unless he is estopped from denying the legal existence of the corporation.¹²³

3. Where the statute indicates that subscriptions without the required payment shall be void, or that the corporation is prohibited from accepting subscriptions without the required payment, the sub-

¹²¹ *Peoria Inv. Corp. v. Hoagland*, (1939) 300 Ill. App. 54, 20 N.E.(2d) 627; *Davidson v. American Paper Mfg. Co.*, (1937) 188 La. 69, 175 So. 753.

¹²² *Minneapolis and St. Louis Ry. v. Bassett*, (1874) 20 Minn. 535. In *New York & Oswego Midland Ry. v. Van Horn*, (1874) 57 N.Y. 473, the subscription was held invalid under the statute then in force.

¹²³ *Crocker v. Crane*, (1839) 21 Wend. (N.Y.) 211. In *Furlong v. Johnston*, (1924) 239 N.Y. 141, 145 N.E. 910, it was held that failure to make cash payment at the time of the subscription does not necessarily release the subscriber from his obligation notwithstanding a statute requiring immediate cash payment of a given percentage of the subscription price.

scriber will be released from the subscription if the corporation has not obtained the required payment.¹²⁴ There really is no subscription.

The courts disagree as to the effect of a failure to make the initial payment where the statute does not specifically prohibit subscriptions to stock without payment of a deposit, or does not state that such subscriptions shall be void, but merely calls for the payment of a certain percentage with each subscription. In some jurisdictions, a subscription without the payment of a deposit is void under such conditions,¹²⁵ whereas in others, the subscription is not considered void, and the failure to pay the required amount at the time of subscribing is no defense in an action against the subscriber.¹²⁶

Stockholders' liabilities to corporation on stock subscriptions. As previously indicated, unless the general corporation law provides otherwise, a subscriber becomes a stockholder as soon as a binding contract of subscription is made, and he is subject to all the liabilities of a stockholder.¹²⁷ The primary liability of a stockholder is to take and pay for his stock.¹²⁸ This liability is contractual¹²⁹ and may be enforced as such by the company. Since the liability is a debt due the corporation from the stockholder, appropriate legal and equitable remedies for enforcing it are available to the corporation, as in cases of all other valid debts.¹³⁰

The liability of a stockholder to pay to the corporation the purchase price of his stock, or any unpaid balance thereof, must be carefully distinguished from his liability to make similar payment to creditors of an insolvent corporation.¹³¹ Recovery of the purchase

¹²⁴ *Boyd v. Peach Bottom Ry.*, (1879) 90 Pa. St. 169.

¹²⁵ See *State Ins. Co. v. Redmond*, (1880) 1 McCrary (U.S.) 308; *Taggart v. Western Maryland R.R.*, (1886) 24 Md. 563.

¹²⁶ *Smith v. Tallassee Branch of Central Plank-Road Co.*, (1857) 30 Ala. 650; *Wight v. Shelby R.R.*, (1855) 16 B. Mon. (Ky.) 4; *The Sedalia, etc. Ry. v. Abell*, (1885) 17 Mo. App. 645; *Pistagua Ferry Co. v. Jones*, (1859) 39 N.H. 491.

¹²⁷ *Walter A. Wood Harvester Co. v. Robbins*, (1893) 56 Minn. 48, 57 N.W. 317; *Ellis v. Capps*, (1928) 46 Idaho 606, 269 P. 597.

¹²⁸ *Amick v. Elliott*, (1928) 222 Ky. 753, 2 S.W.(2d) 367; *McNelus v. Stillman*, (1916) 172 App. Div. 307, 158 N.Y. Supp. 428.

¹²⁹ *Lamphere v. Lang*, (1915) 213 N.Y. 585, 108 N.E. 82.

¹³⁰ *Peoria Inv. Co. v. Hoagland*, supra (Note 121); *Buckman v. Gordon*, (1942) 312 Mass. 6, 42 N.E.(2d) 811; *Stoddard v. Lum*, (1889) 159 N.Y. 265, 53 N.E. 1108.

¹³¹ This distinction is clearly brought out in *Philips v. Slocomb*, (1933) 35 Del. 462, 167 A. 698, and in *Harr v. Mikalarias*, (1937) 328 Pa. 49, 195 A. 86.

price by the corporation does not depend upon the existence of corporate creditors, but may be enforced according to the terms of the contract of subscription.¹³² Unless the statute provides otherwise, the stockholder's liability to the corporation for the purchase price of his stock, or for the unpaid portion thereof, is several and not joint,¹³³ and extends only to the purchase price, or the unpaid part thereof, of the stock subscribed for by the stockholder individually.¹³⁴ However, there are exceptions to this rule. In a few states, stockholders of a solvent corporation may be held jointly and severally liable for the wage debt owed the corporate employees by the corporation.¹³⁵ The statutes¹³⁶ of these states nevertheless limit the liability of the stockholders to the value of shares they own.¹³⁷ Furthermore, stockholders will not be held liable if an employee's action to enforce such claim is not brought within a statutory period.¹³⁸ If a stockholder has paid more than his proportionate share, he is entitled to a claim for contribution against the other stockholders. After paying the debt, stockholders can enforce the claim against the corporation.¹³⁹

Stockholders' liabilities to corporation for interest. Included in the liability to pay for the stock is the liability to pay interest, at the legal rate, on the unpaid balance of the purchase price, unless provided otherwise in the contract of subscription.¹⁴⁰ Interest gen-

¹³² *Geary St., P. & O. R.R. v. Rolph*, (1922) 189 Cal. 59, 207 P. 539; *Philips v. Slocomb*, supra (Note 131).

¹³³ *Terry v. Little*, (1880) 101 U.S. 864; *Edwards v. Schillinger*, (1910) 245 Ill. 231, 91 N.E. 1048; *Williams v. Chamberlain*, (1906) 29 Ky. 606, 94 S.W. 29.

¹³⁴ *Shipman v. Portland Constr. Co.*, (1913) 64 Ore. 1, 128 P. 989.

¹³⁵ In New York, salaries and wages include all payments for overtime, vacations, holidays, severance, insurance, welfare benefits, and pension plans. See *Rogers and McManus*, "Stockholders' Booby-Trap," 28 N.Y.U.L. REV. 1149.

¹³⁶ The constitutionality of the Pennsylvania law has been upheld. See *Eiffert v. Pennsylvania Cent. Brewing Co.*, (1940) 141 Pa. Super. 543, 15 A.(2d) 723, comment, 89 U. PA. L. REV. 674; *Jago v. Albion Slate Co.*, (1938) (Pa.) 32 D. & C. 663.

These statutes are penal in nature and are, therefore, strictly construed. See *Kabaker v. Gelb*, (1941) 52 N.Y.S.(2d) 678.

¹³⁷ Basis of liability of holder of no-par stock for wages of employees is consideration paid for the stock, not value based on appraisal of corporate assets. *Parish v. Awschu Properties, Inc.*, (1943) 243 Wis. 269, 10 N.W.(2d) 166.

¹³⁸ Statutory action to enforce a claim must be brought within six months from the day on which the salary or wage is due and payable and no payment is made. *Reich v. Deigler*, (1940) (Pa.) 39 D. & C. 8. See also *Wisconsin B.C.L. §180.40*.

¹³⁹ In *re Dorr Pump & Mfg. Co.*, (1942) 125 F.(2d) 610.

¹⁴⁰ In the absence of a contrary provision, a stock subscription contract bears interest on each installment from the time it becomes due. *Eastern, etc. Exposition v. Vail's Estate*, (1923) 96 Vt. 517, 121 A. 415.

erally runs from the date of default to the date of payment.¹⁴¹ In the absence of a provision for call for payment in the contract of subscription, interest runs from the due date of the subscription. This may be the day the contract of subscription is entered into, if the purchase price is immediately payable, or the date fixed for payment, when, by the contract of subscription, the purchase price is made payable on a certain day.¹⁴²

Effect of transfer of subscription or stock upon liability to corporation. A transferor of stock who makes an absolute transfer in good faith is relieved of further liability for calls upon an unpaid subscription if the transfer is duly recorded on the books of the corporation.¹⁴³ In most states it is the law, either common or statutory, that the transferee is liable for all calls made after the transfer, but not for those made prior to the transfer.¹⁴⁴ The law of the state of corporate organization, rather than the law of the state in which the transferee resides, governs.¹⁴⁵ The liability at common law is based on "novation," that is, on a substitution of the transferee for the transferor as the debtor of the corporation for the balance unpaid on the stock.¹⁴⁶ The date of the call, not the date when it becomes payable, fixes the liability as between transferor and transferee.¹⁴⁷ To escape liability for calls by a transfer of his shares, a stockholder must act in good faith.¹⁴⁸ If a transfer is made for the mere purpose of avoiding liability, the transferor remains liable, since such a transfer is fraudulent and void.¹⁴⁹ Unless the transferee accepts the transfer, the transferor remains liable.¹⁵⁰

¹⁴¹ *Bergman v. Evans*, (1916) 92 Wash. 158, 158 P. 961.

¹⁴² *Mountain Timber Co. v. Case*, (1913) 65 Ore. 417, 133 P. 92.

¹⁴³ *Webster v. Upton*, (1875) 91 U.S. 384.

¹⁴⁴ *Geary St., P. & O. R.R. v. Bradbury Estate Co.*, supra (Note 132); *Sigua Iron Co. v. Brown*, (1902) 171 N.Y. 488, 64 N.E. 194.

¹⁴⁵ *Black v. Zacharie*, (1845) 44 U.S. 527. See also *Priest v. Glenn*, (1892) 51 F. 400; *McConey v. Belton Oil & Gas Co.*, (1906) 97 Minn. 190, 106 N.W. 900.

¹⁴⁶ *Campbell v. American Alkali Co.*, (1903) 125 F. 207; *West Nashville Planning-Mill Co. v. Nashville Sav. Bank*, (1888) 86 Tenn. 252, 6 S.W. 340.

¹⁴⁷ *Campbell v. American Alkali Co.*, supra (Note 146).

¹⁴⁸ *Rochester & K. F. Land Co. v. Raymond*, (1889) 158 N.Y. 576, 53 N.E. 507.

¹⁴⁹ *Bowden v. Johnson*, (1882) 107 U.S. 251, 2 S. Ct. 246; *The Germania Nat'l Bank v. Case*, (1878) 99 U.S. 628.

¹⁵⁰ *Russell v. Easterbrook*, (1898) 71 Conn. 50, 40 A. 905.

If paid-up stock is assessable, the transferees are liable for assessments made after the transfer.¹⁵¹

Set-off of debts due stockholders. A stockholder who is liable for unpaid stock may be a creditor of the corporation. Whether or not he may set off the corporation's indebtedness to him against his liability depends upon the governing statutes and upon the remedies available to creditors. Where the statute views the subscribed capital stock of a corporation, both paid and unpaid, as a trust fund out of which creditors are to be satisfied, or where the stockholder seeks the set-off in an equitable action in which all stockholders and creditors are before the court, the right of set-off does not exist, for it would operate as a preference.¹⁵² A set-off has in some jurisdictions been allowed in proceedings under a statute permitting an individual creditor to sue for enforcement of the stockholder's liability.¹⁵³ In other jurisdictions, however, it has not been permitted, even though the trust fund theory did not prevail and even though the creditors, to enforce this liability, could sue the stockholders directly.¹⁵⁴

Stockholders may set off the debt due from the corporation where their liability is to the corporation, as upon an unpaid subscription.

FORMS RELATING TO SUBSCRIPTIONS TO STOCK

Form 731—Individual subscription agreement between a subscriber and a proposed corporation, showing payment to be made in property, cash, or services.

WHEREAS, it is proposed by certain interested parties to organize a corporation under the laws of the State of, to be known as

¹⁵¹ Libby v. Tobey, (1890) 82 Me. 397, 19 A. 904. A transferor who has been compelled to pay an assessment after transfer may recover the amount paid from the transferee, where the latter failed to have the certificate transferred to the books of the corporation. Gaffney v. People's Trust Co., (1920) 191 App. Div. 697, 182 N.Y. Supp. 451, aff'd (1921) 231 N.Y. 577, 132 N.E. 895.

¹⁵² Sawyer v. Hoag, (1872) 84 U.S. 731, 17 Wall. 610; Livingston v. Adams, (1931) (Mo. App.) 43 S.W.(2d) 836; Reimers v. Larson, (1925) 52 N.D. 297, 202 N.W. 653; Andrews v. State, (1931) 124 Ohio St. 348, 178 N.E. 581; Russell v. Tennessee & Kentucky Tobacco Co., (1933) 16 Tenn. App. 561, 65 S.W.(2d) 256; Austin v. Cochran, (1928) (Tex. Civ. App.) 2 S.W.(2d) 1015.

¹⁵³ Pierce v. Topeka Comm. Security Co., (1899) 60 Kan. 164, 55 P. 853; Broadway Nat. Bank v. Baker, (1900) 176 Mass. 294, 57 N.E. 603; Yardly v. Caruthersville Motor Co., (1931) 225 Mo. App. 321, 35 S.W.(2d) 971.

¹⁵⁴ H. K. McCann Co. v. Week, (1931) 115 Cal. App. 393, 1 P.(2d) 452.

....., with its principal office and place of business at (Street),..... (City), ... (State), said Corporation to have an authorized capital stock of (.....) shares of Class A stock having a par value of (\$.....) Dollars per share, and (.....) shares of Class B stock without par value:

NOW, THEREFORE, I, ..., do hereby subscribe to (.....) shares of the Class B stock of the said Corporation, on the following terms and conditions:

1. Payment for said subscription shall be made at the rate of (\$.....) Dollars per share.

2. There shall be credited to the amount due on said subscription the sum of (\$.....) Dollars, representing advances made by me for and in behalf of the corporation up to the time of incorporation.

3. The said subscription shall be payable in cash, in property, or in services rendered to the Corporation by me before or after incorporation, and accepted by the Board of Directors, at such reasonable valuation as the Board shall determine.

4. Payment for said subscription shall be made within (.....) years from the date of incorporation of said Corporation, in such amounts and at such time or times within said period as shall be determined by me.

5. The said Corporation shall issue to me a certificate for the full amount of said subscription as soon as possible after the organization of said Corporation is completed, and shall note thereon the amount paid on said subscription by me up to the time of incorporation, and all sums thereafter paid by me on account of said subscription.

6. The said Corporation shall, at any time, at my request, transfer as fully paid and nonassessable, any or all shares of stock that shall be fully paid for by me at the rate of (\$.....) Dollars per share up to the time of transfer, and the proper officers shall issue a new certificate or certificates for such shares so transferred to whomsoever I may direct. In the event that less than all of the shares hereby subscribed for by me are transferred as aforesaid, the proper officers shall issue to me a new certificate, representing the difference between the number of shares hereby subscribed for and the aggregate number of shares so transferred, and shall note thereon the amount paid for said subscription, including moneys advanced before incorporation, and the sum represented by the stock transferred—that is, ... (\$.....) Dollars times the number of shares transferred.

Dated , 19....

.....

Form 732—Subscription agreement prior to organization in which the subscribers contract with each other and with the promoters.

WHEREAS, it is proposed to organize under the laws of the State of, a corporation, to be known as, or by such other name as the parties in interest may determine; and

WHEREAS, it is proposed that said Corporation shall transact the business of, and

WHEREAS, it is proposed that the said Corporation shall have an authorized capital stock of (\$.....) Dollars, divided into (.....) shares of the par value of (\$.....) Dollars each,

NOW, THEREFORE, the signers hereto, in consideration of their mutual promises, do severally agree with one another, and with, the promoter and founder of said Corporation, that they will take and pay for, and they do hereby severally subscribe to, the number of shares of the capital stock of said Corporation set opposite their respective names; and they do further severally agree to pay for said shares at their par value, in the following manner: (%) per cent of their subscriptions immediately upon organization of the Corporation and upon notice to that effect from; (%) per cent within (.....) months thereafter; and the remaining (%) per cent on demand and when called for by the Board of Directors of the Corporation, but not later than (.....) months after incorporation of said Corporation.

Dated, 19....

<i>Name</i>	<i>Residence</i>	<i>Number of Shares</i>	<i>Amount</i>
.....			
.....			
.....			

Form 733—Subscription to stock, to be paid for by cash and note; issuance of stock upon payment of note; effect of default in payment; power of corporation to reject application; obligation to offer stock to corporation before transfer.

I hereby subscribe for (.....) shares of the Preferred Stock of the Corporation, ... (City), ... (State), and agree to pay therefor one hundred (\$100) Dollars per share, on the following terms: Not less than one fourth in cash, accompanying this application, and the balance thereof, as evidenced by my promissory

note of this date, with interest at six (6%) per cent per annum, payable days after date.

It is expressly agreed that no stock is to be issued until the amount of this subscription and note given therefor are paid in full in cash, and any payment becoming due on the stock hereby subscribed for, or any note given therefor, not paid within sixty (60) days after its due date, shall, at the option of the Corporation, cause this subscription and any note or notes given therefor to become null and void, and all payments made on this subscription by the subscriber shall become the property of the Corporation absolutely as liquidated damages for the failure of the subscriber to carry out this contract.

The Corporation may reject this application by refunding all moneys paid thereon.

This subscription contract contains the entire contract between the subscriber and the Corporation, and no agent or representative of the Corporation or any other person has any power to change or alter the terms of this subscription.¹⁵⁵

I hereby agree that, before selling or agreeing to sell the stock hereby subscribed for, I will first offer same to the Corporation.

All payments will be made to the Corporation, at(City), ... (State).

Dated this day of, 19.....

.....
(Name of subscriber)

.....
(Address)

Form 734—Subscription to stock; part payment at time of subscription, balance before fixed date; application of subscription price; reservation of right to reject or allot subscriptions; issuance of receipts.

SUBSCRIPTION AGREEMENT

NEW ISSUE

..... SHARES

¹⁵⁵ See *Hedman v. Security Title & Guaranty Co.*, (1935) 245 App. Div. 224, 281 N.Y. Supp. 565, in which it was held that the provision on a printed agreement for the sale of guaranteed mortgage certificates, that no agent or other person had permission to change or in any way alter the terms of the agreement or bind the company by any representations, oral or written, not contained therein, applied only to the negotiations leading up to the execution of the agreement. Where the agreement was executed in accordance with the printed form, the provision did not prevent modification of the agreement by a district manager after its execution.

.....COMPANY OF THE CITY OF
 AUTHORIZED CAPITAL SHARES, PAR VALUE \$.....
 PRESENT OFFERING SHARES AT \$..... PER SHARE
 PAYABLE \$..... PER SHARE WITH SUBSCRIPTION,
 BALANCE , 19....
 COMPANY'S TREASURY WILL RECEIVE ENTIRE PROCEEDS OF THIS
 STOCK, FULLY PAID AND NONASSESSABLE. NO PERSONAL LIABILITY
 ATTACHES TO STOCKHOLDERS

The undersigned hereby subscribes at one hundred (\$100) Dollars per share for (.....) shares of the capital stock of Company of the par value of (\$.....) Dollars each, and agrees to pay (\$.....) Dollars therefor, as follows: (\$.....) Dollars (at least \$..... per share) herewith: Balance on or before , 19....

TERMS AND CONDITIONS OF SUBSCRIPTION

..... (\$.....) Dollars per share shall be applied to the capital of the Company, and (\$.....) Dollars per share shall be applied to the surplus and reserve funds of the Company.

It is understood and agreed that the Company reserves the right to accept subscriptions in excess of the present offering and to issue stock therefor, including the right to increase, to the extent of an additional (.....) shares, the authorized capital stock of the Company, if necessary, to provide for subscriptions accepted. The Company also reserves the right to reject, reduce, and/or allot all subscriptions received.

Receipts will be issued in respect of payments received on account of subscriptions, the amount represented thereby to be applied toward payment for the number of shares finally allotted.

Checks for payments on account of subscriptions shall be drawn to the order of Company, and may be forwarded to the following firms, banks, or trust companies or their branches:

..... (Name of bank)	 (Name of bank)
..... (Address)	 (Address)

Subscription books will close at P.M., ... , 19....

IN WITNESS WHEREOF, I (we) have hereunto set my (our) hand(s) and seal(s), this day of, 19.....

.....
(Signature)

.....
(Address)

.....
(Witness)

Form 735—Letter containing offer to subscribe to stock.

..... Co.
..... CITY, ... STATE
....., 19.....

Gentlemen:

We hereby subscribe to (.....) shares of your Common Stock without nominal or par value at the subscription price of (\$.....) Dollars per share, and hand you herewith (\$.....) Dollars, representing (%) per cent payment on account of such subscription, the balance of the subscription to be payable on call of the Board of Directors of your Company, provided not less than (.....) days' notice of such call shall be given.

Will you kindly indicate your acceptance of this offer by signing in the space below, and thereby constitute this an agreement between us.

Very truly yours,

Accepted, ... , 19.....

..... Co.

..... Co.

By

By

President

Vice-President

Form 736—Application for stock on cash plan or monthly payment plan, in accordance with circular;¹⁵⁶ right to reject or reduce application; adjustment of accrued dividends and interest allowances.¹⁵⁷

To , 19.....
..... Company, Inc.,
.....
(Address)

¹⁵⁶ Other writing may sometimes be included as part of the subscription agreement. See Co-operative Tel. Co. v. Katus, (1905) 140 Mich. 367, 103 N.W. 814.

¹⁵⁷ For right to allow interest on installments paid, see Hardin County v. Louisville & N. R.R. (1891) 92 Ky. 412, 17 S.W. 860.

I hereby apply for shares of Class A stock of the
Company, in accordance with the terms of your circular of
....., 19....., as follows:

..... CASH PLAN—Approximate payment in full to accompany
No. of Shares the application; difference between this payment and
cost of stock to be refunded or collected before delivery
of certificate.

..... MONTHLY PAYMENT PLAN—Payment to be made in total
No. of Shares monthly installments of \$..... (first payment \$.....
per share, subsequent monthly payments \$....., or
multiple thereof per share), first payment to accom-
pany application; an adjustment for accrued dividends
and interest allowances to be made in connection with
final payment.

Total amount of payment made on account of this application, \$.....
Please make remittances payable to the Company, Inc.

.....
(Signature of applicant—give first or middle name in full;
if a woman, indicate whether "Miss" or "Mrs.")

Applicant will please also PRINT name in this space
Applicant's address to which stock certificates and notices should be
mailed:

.....
(Street and Number) (City or Town) (State)

It is understood that you may reject this application or accept it for a
lesser number of shares.

(see reverse side of application)

[reverse side of application]

PRICE

The price per share is the price at which the last sale is made on the
American Stock Exchange on the day on which the application is received
by the Company, plus an amount equal to brokerage
charges, which at present are (.....¢) cents a share. The ap-
plicant will be notified of the price at which the application is accepted.

PAYMENT IN FULL PLAN

Stock may be paid for in full by a single payment to accompany the ap-
plication.

MONTHLY PAYMENT PLAN

Monthly payments shall be (\$.....) Dollars or any mul-

title thereof per share. A first payment of (\$.....) Dollars per share must accompany the application.

Interest will be allowed on each monthly payment, at the rate of (.....%) per cent per annum, from the first of the month on payments received on or before the day of such month; otherwise from the day of the following month. An adjustment on account of accrued dividends will be made in connection with the final payment.

The applicant will, upon request, be granted one extension of monthly payments for not exceeding months. The applicant may, at any time, take up any or all of the shares applied for by payment of the balance due.

At any time prior to the final payment, the applicant may elect, by written notice, to have his contract cancelled as to any or all of the shares applied for, in which case he will be refunded the amount paid in, with interest at the rate of (.....%) per cent per annum; or, he may take up the number of shares which the amount paid in, plus interest at the rate of (.....%) per cent per annum, will pay for in full, any balance to be refunded in cash. However, if, on the day of such cancellation, the last sale of the stock is made on the American Stock Exchange at a price less than the price to be paid for the shares (including adjustment for accrued dividends), the applicant will be charged with the difference. The Company reserves the right to reject any application under either option, or to accept it for a lesser number of shares, and to withdraw this offer at any time without notice, and to cancel the application, with refund under the above terms, in case of an unadjusted difference with the applicant, or if a monthly payment is not received within months after it is due.

..... Company
By
President

Dated, 19....

Form 737—Notice of allotment of shares.

..... COMPANY
..... CITY, ... STATE

Dear:

Respecting your recent subscription to (.....) shares of the capital stock of Company, you have been allotted (.....) shares, and your subscription has been accepted to this extent. The following is a statement of your account:

1. Number of shares allotted (.....) at \$30 per share \$.....
2. Paid at time of subscription \$.....
 Paid since filing of subscription \$..... \$.....
 Balance due or (if item No. 2 exceeds item No. 1)
 amount of overpayment \$.....

Payment of balance due on allotted shares is due and payable by
, 19...., at the office of the undersigned bank.

Check for overpayment, if any, will be sent on or about
, 19....

The undersigned will be prepared to deliver on
 19...., definitive or temporary stock certificate for the number of shares
 allotted.

Yours very truly,

.....
 (Insert name of bank)

Depository for Company

Form 738—Receipt for note and cash payment on subscription.¹⁵⁸

No. Amount \$.....
, 19....

RECEIVED, of, of (City), ...
 (State), the sum of (\$.....) Dollars and note(s) for
 (\$.....) Dollars of even date, all payable to the order of the
 Company, in payment for (.....) shares of the capital stock
 of the Company.

.....
 (see reverse side)

(The reverse side of the receipt contains a duplicate of the subscription contract.)

Form 739—Receipt for full payment of subscription price.

..... (City), ... (State), ... 19....

RECEIVED, of, ... (\$.....) Dollars in full
 payment for (.....) shares of stock of
 Corporation.

This receipt will be exchangeable, on surrender, for an engraved cer-
 tificate when said certificate is completed and ready for delivery.

..... Corporation

By

President

¹⁵⁸ See *Long v. Mayo*, (1931) 156 Va. 185, 157 S.E. 767, in which it was held that a receipt for cash and note given in payment of stock may be construed as forming part of the contract of subscription.

Form 740—Transfer of subscription; assumption of liability by transferee; consent of corporation and other subscribers.

KNOW ALL MEN BY THESE PRESENTS, That I, ..., in consideration of (\$.....) Dollars, lawful money of the United States, to me paid before the ensealing and delivery of these presents, the receipt whereof is hereby acknowledged, and for other good and valuable considerations, have sold, assigned, transferred, and set over, and by these presents do sell, assign, transfer, and set over unto, my right, title, and interest as a subscriber to and an incorporator of, a corporation organized under the laws of the State of, to the extent of (.....) shares, and I do hereby request and direct the said Corporation to issue the certificate for said (.....) shares to and in the name of said, or such other person as he may name.

IN WITNESS WHEREOF, I have hereunto set my hand and seal, this day of, 19.....

..... (L.S.)

Sealed and delivered in the presence of:

.....

IN CONSIDERATION of the above transfer of subscription, I hereby assume all liabilities, obligations, and duties attached to said subscription for said (.....) shares of the capital stock of the said Corporation, or devolving upon me by reason thereof.

..... (L.S.)

Witness:

.....

The undersigned hereby consent to the foregoing Transfer of Subscription.

Witness:

..... Corporation

.....

By

Witness:

President

.....

..... (L.S.)

..... (L.S.)

..... (L.S.)

Original Subscribers to
Capital Stock of

.....

Corporation

Form 741—Resolution of directors authorizing subscriptions to be taken for remaining unissued stock, and requiring part payment with subscription.

RESOLVED, That subscriptions for the remainder of the authorized capital stock at par, amounting to (.....) shares of unissued Common Stock, be opened forthwith at the office of the Company, and that each subscriber shall be required to pay to the Treasurer at least (.....%) per cent of the amount of his subscription in cash at the time of subscribing, the balance to be paid upon call made pursuant to the statutory and By-law requirements.

Form 742—Resolution of directors appointing agent to receive subscriptions to capital stock.

RESOLVED, That the Trust Company be, and it hereby is, appointed the agent of this Company for the purpose of receiving subscriptions to its capital stock and is hereby authorized to counter-sign any subscriptions, warrants, or receipts in the form approved by this Board, which shall have been signed by the Company's Treasurer, or by its Assistant Treasurer;

RESOLVED FURTHER, That all moneys received by the Trust Company on such subscriptions be held subject to the order of this Company, to be paid out only upon checks signed by any two of the following officers:, President;, Vice-President;, Treasurer; and, Assistant Treasurer.

Form 743—Resolution of directors refusing to accept subscriptions.

RESOLVED, That the following subscriptions to the Common Stock of this Corporation be refused, and that the Secretary be, and he hereby is, directed to notify the persons concerned of this action of the Board.

<i>Name of Subscriber</i>	<i>Address</i>	<i>Shares</i>
.....		
.....		
.....		

Form 744—Resolution of directors authorizing partial release of subscribers.¹⁵⁹

¹⁵⁹ This resolution must have the unanimous consent of the stockholders. Generally, subscriptions for corporate stock cannot be canceled so as to release stockholders without the consent of all stockholders or subscribers in the absence of special adequate reason and consideration for cancellation and release. *Marcuse v. Board-Grace Arcade Corp.*, (1935) 164 Va. 553, 180 S.E. 327. See also 4 *Fletcher, ENCYC. CORPORATIONS*, 1743.

RESOLVED, That all subscribers who subscribed to the Common Stock of this Corporation prior to the day of, 19...., be, and they hereby are, authorized to surrender one-half of the amount of stock subscribed for, or as much less as they may prefer, and the installments paid heretofore by said persons on account of the subscription price shall be applied as if they had been made upon the amount of the subscription retained, and shall be credited to them accordingly; provided that, if any subscribers to the stock of this Corporation who surrender one-half or other part of their subscription shall omit to pay any installment that may be hereafter called for, on the amount retained, such subscribers shall be considered as having waived this offer, and shall be bound for the amount of Common Stock originally subscribed for.

Form 745—Resolution of stockholders ratifying release of subscribers by the corporation.

RESOLVED, That the action of the Board of Directors of this Corporation, releasing subscribers from their subscriptions to stock of this Corporation, as expressed in a resolution adopted by the Board of Directors on the day of, 19...., which resolution reads as follows:

(Here insert Form 744)

be and the same hereby is approved.

Form 746—Resolution of stockholders releasing conditional subscribers upon inability of corporation to meet condition.

WHEREAS, at and before the organization of this Company, the following parties agreed to subscribe for the Common Stock of this Company, in the amounts set opposite their names—to wit:

"A"			shares
"B"			shares
"C"			shares
"D"			shares

and

WHEREAS, the said "A" and "B" subscribed for the number of shares of stock set opposite their respective names as above, upon the condition that the same should be paid for in services to be rendered this Corporation in the construction of a fourteen-story building to be located at the

La Fayette County Monument Corp. v. Ryland, (1891) 80 Wis. 29, 49 N.W. 157, holding that the directors have no power to release subscribers to stock from payment of their subscriptions. See Form 745.

corner of and Streets in the City of,
State of, and the said "C" and "D" subscribed for the num-
ber of shares of stock set opposite their respective names as above, upon
the condition that the Company would proceed forthwith to erect the
said building upon said lot, and the said "C" and "D" have paid in upon
said stock subscriptions the following amounts—to wit:

"C"	\$.....
"D"	\$.....

and

WHEREAS, it has become unnecessary for "A" and "B" to render the
Corporation that it is not expedient at this time to proceed with the erec-
tion of said building, in view of the fact that a sufficient amount of stock
has not been subscribed to enable the Corporation to proceed therewith,
and

WHEREAS, it has become unnecessary for "A" and "B" to render the
services with which they were to pay for their respective subscriptions,
be it

RESOLVED, That each of the subscribers to the Common Stock of this
Corporation above mentioned be, and he hereby is, released from any
and all liabilities on his subscription to the stock of this Corporation, it
being recognized by the stockholders of this Corporation that the Cor-
poration is unable to fulfill the conditions upon which said subscriptions
were made, and

RESOLVED FURTHER, That the Treasurer be, and he hereby is, authorized
and directed to remit to "C" the sum of (\$.....) Dollars and
to "D" the sum of (\$.....) Dollars being the amounts paid
in upon said stock subscriptions by the said "C" and "D" respectively.

CHAPTER 19

ISSUANCE OF CAPITAL STOCK; STOCK PURCHASE WARRANTS AND OPTIONS

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Issuance of Capital Stock; Stock Purchase Warrants and Options

ISSUANCE OF STOCK

Power of corporation to issue capital stock. The power of a corporation to issue capital stock must be expressly conferred upon it either by the general corporation law under which it is organized or by the articles of incorporation.¹ The articles of incorporation, by stipulating the number of shares authorized, fix the maximum amount of stock that the corporation may issue.² After the corporation has issued the full amount of its authorized capital stock, it cannot issue any more stock unless it increases the amount of its capital stock in the manner prescribed by law.³ After an additional issue is authorized, the laws that apply to the original issue generally apply to the additional issue.⁴ If stock is issued in excess of the maximum fixed in the certificate or articles of incorporation, without increasing the amount of the authorized capital stock pursuant to the statute, the stock is void,⁵ even if it is in the hands of a bona fide purchaser for value.

Stock that the corporation has the power to issue, but that it

¹ *Bodell v. General Gas & Elec. Corp.*, (1927) 15 Del. Ch. 420, 140 A. 264; *Savic v. Kramlich*, (1932) 52 Idaho 156, 12 P.(2d) 260; *Lewis v. Oscar C. Wright Co.*, (1930) 234 Ky. 814, 29 S.W.(2d) 566; *Reno Oil Co. v. Culver*, (1901) 60 App. Div. 129, 69 N.Y. Supp. 969.

² *Mitchell v. Mitchell Woodbury Co.*, (1928) 263 Mass. 160, 160 N.E. 539. In some jurisdictions, a permit from some state commission or designated state official may be required before stock can be issued. *Kress v. Tooker-Jordan Corp.*, (1930) 103 Cal. App. 275, 284 P. 685.

³ *Commissioner of Banks v. Tremont Trust Co.*, (1927) 259 Mass. 162, 156 N.E. 7; *Bahr v. Breeze Corp.*, (1940) 127 N.J. Eq. 257, 12 A.(2d) 678; *Larsen v. The Lilly Estate*, (1949) 34 Wash. (2d) 39, 208 P.(2d) 150, 10 A.L.R.(2d) 580.

⁴ *State ex rel. Weede v. Iowa Southern Utilities Co.*, (1942) 231 Iowa 784, 2 N.W.(2d) 372.

⁵ *Scovill v. Thayer*, (1881) 105 U.S. 968; *Crawford v. Twin City Oil Co.*, (1927) 216 Ala. 216, 113 So. 61; *Taylor v. Lounsbury-Soule Co.*, (1927) 106 Conn. 41, 137 A. 159; *Pruitt v. Oklahoma Steam Baking Co.*, (1913) 39 Okla. 509, 135 P. 730.

issues irregularly, is valid so far as the holder is concerned, and in a suit for the payment of the stock, the stockholder may not defend on the ground that the stock was irregularly issued. The state alone may raise the question of irregularity.⁶

Issuance of authorized stock. The power to authorize the issuance of stock is usually vested in the board of directors.⁷ Action in regard to the issuance of stock must be taken by the directors at a valid meeting, regularly called. However, if all the stockholders and directors are present and concur in the authorization of an issue of stock, formal action by the board of directors is unnecessary. In such a case the board will be presumed to have ratified the action of the stockholders, although actually it did not give the matter any formal consideration.⁸ The kind of stock to be issued, the consideration for which the stock is to be issued, and the manner of issuing the stock are governed by the laws of the state in which the corporation is organized,⁹ by the certificate of incorporation, and by the provisions of the by-laws of the corporation. The requirements must be met by those authorizing issuance.

The resolution adopted by the directors authorizing the issuance of stock should contain the following information: (1) the kind of stock to be issued; (2) the amount to be issued; (3) the price at which the stock is to be sold; (4) the consideration to be received for the stock; (5) the terms of the sale; and (6) authority for the proper officers to issue and deliver the certificates of stock upon payment.

Under the corporation laws of some states, it is necessary for the corporation to file a certificate with the Secretary of State or some other designated official, showing that the directors have authorized the issuance of stock (or have issued stock) and giving other required

⁶ *Upton v. Tribilcock*, (1875) 91 U.S. 45; *In re Rombach & Co.*, (1926) 9 F.(2d) 359; *Randall v. Mickle*, (1931) 103 Fla. 1229, 138 So. 14, 141 So. 317. Compare *Benedict v. Anderson*, (1934) 70 F.(2d) 227.

⁷ *Rice & Hutchins v. Triplex Shoe Co.*, (1929) 16 Del. Ch. 298, 147 A. 317; *Elliot v. Kern*, (1928) 90 Ind. App. 453, 161 N.E. 662.

⁸ *Fitzpatrick v. O'Neill*, (1911) 43 Mont. 552, 118 P. 273. In *East Lake Lumber Co. v. Van Gorder*, (1919) 105 N.Y. Misc. 704, 174 N.Y. Supp. 38, it was held that no formal resolution was necessary for the issuance of stock, where the stock was in fact issued as a result of corporate action, acquiesced in by the stockholders, and was part of the very plan and purpose which underlay the formation and organization of the corporation. See also *Belle Island Corp. v. MacBean* (1946) 27 Del. Ch. 261, 49 A.(2d) 5.

⁹ *Young v. Titcomb*, (1929) 268 Mass. 14, 167 N.E. 286.

information.¹⁰ Under the blue-sky laws of some states, certain corporations are required to obtain authority from a designated state commission or officer before stock authorized to be sold and issued by proper authority of the corporation may actually be issued.¹¹

Registration of stock under Securities Act of 1933, as amended. Before any action is taken on the disposition of stock, it is important to determine whether or not the sale of the securities is subject to the federal Securities Act of 1933, as amended.¹² The purposes of this Act are: (1) to provide full and fair disclosure to prospective investors of the character of the new offerings of securities, and (2) to prevent fraud and misrepresentation in the sale of the securities.

To effect the first purpose, the Act requires that, before new offerings of securities may be made to the public through the mails or through the channels of interstate commerce, the securities must, with certain exceptions, be registered with the Securities and Exchange Commission by the filing of a registration statement. This statement must contain certain specified details regarding the securities, calculated to enable the buying public to judge the value of the security offered. The accounting expenses involved in ascertaining the information required for registration may be minimized by issuing the securities immediately after the end of the fiscal year when current financial statements are available. The Act also requires the use of prospectuses containing information similar to that contained in the registration statement. Civil liabilities and criminal penalties are imposed for noncompliance with registration and prospectus requirements. To effect the second purpose, the Act imposes civil liabilities and criminal penalties for the sale of any securities by means of fraud or misrepresentation.

The primary duty of registering the securities would appear to rest with the issuer of the securities. However, any person who sells

¹⁰ *Clark v. Millsap*, (1926) 197 Cal. 765, 242 P. 918. In *Black v. Taft*, (1933) 284 Mass. 77, 187 N.E. 96, an issue of stock was held illegal because no certificate of issue had been filed with the commissioner of corporations as required by statute. For a criticism of the decision in this case, see 82 U. PA. L. REV. 284. Contra: *Chicago Title Co. v. Central Republic Trust Co.*, (1939) 299 Ill. App. 483, 20 N.E.(2d) 351.

¹¹ For a discussion of the effect of the sale of securities in violation of blue-sky laws, see 23 MINN. L. REV. 828.

¹² For complete information regarding the Securities Act of 1933, as amended, see *Prentice-Hall Securities Regulation*.

an unregistered security that should have been registered may be liable to the purchaser. Penalties are also imposed on anyone who sells securities in interstate transactions or through the use of the mails unless a required registration statement is in effect.

Private placement. The Securities Act of 1933, as amended, permits the sale of securities without registration if the sale is not a public offering.¹³ Corporations frequently sell their new securities directly to one, or a few, institutional investors under this exemption from the registration provision. This method of financing has several advantages that should be weighed: (1) The financing may be accomplished more rapidly since the process of registering the security and marketing it to a large number of persons is unnecessary. (2) Expenses are smaller than the usual expenses of public sale. (3) The credit of the issuing corporation may be enhanced by a private sale to an institutional investor that enjoys a reputation of prudent investment policy. (4) Corporate financial adjustments are less cumbersome if there is a smaller number of creditors and shareholders.

The disadvantages are usually: (1) The unregistered securities are less marketable in the hands of the investor. (2) The corporation can not easily make beneficial transactions in such securities.

Registration of stock under Securities Exchange Act of 1934.¹⁴ In addition to registration of stock under the Securities Act of 1933, as amended, it must also be determined whether or not registration is required under the Securities Exchange Act of 1934, as amended. The purposes of the Securities Exchange Act of 1934 are: (1) to com-

¹³ The general criteria to be considered in determining whether an issue is a public offering are: (1) the number of offerees and their relationship to each other and to the issuer; (2) the number of units offered; (3) the size of the offering; and (4) the manner of offering. See Securities Act Release No. 285 (1935); "Executive Compensation and Federal Securities Legislation," 55 MICH. L. REV. 1115, which discusses cases deciding whether an offering to employees is a public offering. The United States Supreme Court has decided this specific question on the basis of whether or not the employee-investors are of a class of persons who need the protection of the registration provisions of the act. *SEC v. Ralston Purina Co.*, (1953) 346 U.S. 119, 73 Ct. 981. See also 12 SO. CALIF. L. REV. 473.

If the investor intends to resell the security, or if there is a high degree of probability that a resale will be made, it is a public offering. The fact, however, that the securities are later sold by the investor will not, per se, make the original sale a public offering. A corporation should satisfy itself that the prospective investor does not intend to resell and should require a signed certificate so stating or promising.

¹⁴ For complete information regarding the Securities Exchange Act of 1934, as amended, see Prentice-Hall *Securities Regulation*.

pel corporations to furnish adequate information regarding securities publicly traded in, (2) to control unfair use of information by corporate insiders, and (3) to regulate securities exchanges and markets. The Act also seeks to prevent unfair practices on such exchanges and markets, and to prevent the use of credit in financing excessive speculation in securities.

Information by corporation. The Securities Exchange Act of 1934 requires the registration under the Act of securities listed on an exchange, and the furnishing of periodical and other reports. Registration is effected by filing, with the exchange on which the security is listed, a registration statement containing certain information and accompanied by certain documents listed in the Act. Duplicates of the registration statement are filed by the exchange with the Securities and Exchange Commission. Ordinarily only issued securities may be registered. Unissued securities may be registered only when necessary in the public interest or for the protection of investors. An issuer of a registered security must file with the exchange information and documents necessary to keep current the information and documents filed in registering the securities. Duplicate originals are to be filed with the Commission as required. The issuer must also file annual and other reports as prescribed by the Commission. The Act makes it unlawful for a member of an exchange, or for a broker or dealer, to effect a transaction in any security on a registered exchange unless the security is registered under the Securities Exchange Act. The Act also provides that a registered security may be withdrawn from an exchange listing in accordance with the rules of the exchange and upon terms that the Commission imposes to protect the investors.

Control of acts of insiders. Corporate "insiders" whose acts and transactions are controlled by the Securities Exchange Act of 1934 include owners of more than 10 per cent of any class of registered equity securities,¹⁵ and all directors and officers of a corporation having registered equity securities. Control is exercised by requiring such insiders to file periodic statements with the exchange and with

¹⁵ The expression "equity security" is primarily intended to mean "stock." It also includes (1) bonds convertible into stock, (2) bonds carrying warrant or right to subscribe to stock, (3) any warrant or right to subscribe to stock, and (4) any other similar security that the Commission may, by rules and regulations, treat as an equity security.

the Commission, showing the amount of securities owned by them and any changes in ownership. Profits realized from the purchase and sale of such securities by corporate insiders within any period of less than six months are recoverable by the corporation. The Act further regulates the acts of insiders by prohibiting them from selling stock of their company "short" or "against the box," and by making solicitation of proxies in respect to registered securities subject to rules and regulations of the Commission.

Regulations of securities exchanges and markets. All exchanges must be registered with the Commission as national securities exchanges, except small exchanges exempted by the Commission on application. The Act makes it unlawful for a broker, a dealer, or an exchange to use the mails or the channels of interstate commerce for the purpose of using a facility of an exchange to effect or report a transaction in a security, unless the exchange is registered. The Act also regulates brokers and dealers trading in over-the-counter markets. No broker or dealer may use the mails or the channels of interstate commerce to effect a transaction in any security otherwise than on a registered exchange, unless such broker or dealer is registered with the Securities and Exchange Commission in accordance with its rules.

Underwriting the issuance of stock. The general purpose of underwriting an issue of stock is to guarantee through bankers¹⁶ the successful flotation of the securities.¹⁷ An issue of stock may be

¹⁶ Issuance and sale of a new issue of stock may be underwritten by the stockholders themselves. See *Weichsel v. Jones*, (1937) (Tex. Civ. App.) 109 S.W.(2d) 332, involving such an underwriting agreement.

¹⁷ Strictly speaking, an underwriting is an agreement to purchase shares not taken up upon a public sale. *Marine Nat'l Exchange Bank v. Kalt-Zimmers*, (1934) 293 U.S. 540, 55 S. Ct. 85; *Bone v. Hayes*, (1908) 154 Cal. 759, 99 P. 172; *Stewart v. G. L. Miller & Co.*, (1926) 161 Ga. 919, 132 S.E. 535; *International Products Co. v. Vail's Estate*, (1924) 97 Vt. 318, 123 A. 194; *Fraser v. Home Tel. & Tel. Co.*, (1916) 91 Wash. 253, 157 P. 692. See also 28 COLUM. L. REV. 634; Masslich, "Financing a New Corporate Enterprise," 5 ILL. L. REV. 70-78.

An underwriting agreement must be distinguished from a subscription agreement. In a subscription agreement, the signer unqualifiedly obligates himself to take the amount of securities designated. In the underwriting agreement, the obligation is to take only what is unsold. See *Positype Corp. v. Flowers*, (1930) 36 F.(2d) 617, in which an agreement designated as an "underwriting syndicate agreement" was held to be a subscription contract. See also *In re Danville Hotel Co.*, (1930) 38 F.(2d) 10; *Positype Corp. v. Mahin*, (1929) 32 F.(2d) 202; *Bush v. Stromberg-Carlson Tel. Mfg. Co.*, (1914) 217 F.328.

underwritten whether or not the new securities are first offered to existing stockholders.¹⁸ One of two methods may be used to effect distribution of the stock with the aid of bankers: (1) distribution of the securities to the public after the banker or a group of bankers has purchased the issue of stock outright from the corporation, or has received an option thereon, or has been authorized to act as selling agent; or (2) agreement between the corporation and the bankers, before the securities are offered to the corporation's stockholders, that in the event all the stock offered is not taken up, the bankers or underwriters will purchase the remaining stock from the corporation.¹⁹

The arrangement between the corporation and the bankers is reduced to a written contract, usually in the form of a letter. The contract may be signed by each of the bankers in the group that is underwriting the security issue, or by one banker as agent and representative of the rest of the purchasing group. Each of the bankers assumes a definite contractual liability to take a fixed proportion of the security issue.

The contract entered into by the corporation with the bankers must be duly authorized by proper corporate action. Whether the stockholders or the directors must approve the underwriting arrangement depends upon the nature of the financing and upon the provisions of the statute, charter, or by-laws governing the corporation.

Listing stock on an exchange. Whether or not stock should be listed on an exchange is a question of policy²⁰ to be determined by

For a discussion of the difference between the relation of a corporation to an underwriter and to a subscriber, see "The Nature and Function of Underwriting Agreements," 79 U. PA. L. REV. 941.

¹⁸ For a discussion of the method of distributing securities through underwriting, see Gerstenberg, *Financial Organization and Management*, p. 387, et seq.

¹⁹ For a discussion of underwriting agreements under the Securities Act of 1933, see Lockwood and Anderson, "Underwriting Contracts within Purview of Securities Act of 1933, with Certain Suggested Provisions," 8 GEO. WASH. L. REV. 33.

²⁰ Among the elements to be considered in determining whether or not stock should be listed on a stock exchange, in order to create a market for the stock, are the size of the company's business, the soundness of its financial and business record, the geographical distribution of its stockholdings, the size of the issue, etc. If the company is large, its financial and business record sound, its capital stock distributed over a wide geographical area, and its policies or program requires the employment of large amounts of capital, its management may find it advantageous to list the stock on a stock exchange.

the board of directors.²¹ The details of listing are generally attended to by the secretary of the corporation, often with the aid of bankers or attorneys familiar with the procedure. These details include conferences with the Committee on Listing of the particular exchange, and the preparation and filing of the formal application for listing. If the securities of which the additional amount to be issued is a part, have not previously been listed on the exchange, an application for original listing will be filed with the exchange. If securities previously issued have been listed, it will be necessary to file an application for listing of the additional amount to be issued. Under the requirements of the New York Stock Exchange and other exchanges, when application is made to list stock, the applicant must agree to make application to the stock exchange for the listing of additional amounts of listed securities, sufficiently prior to the issuance thereof to permit action in due course upon such application.

CONSIDERATION FOR STOCK

Nature of consideration to be paid for stock. The corporation must receive a consideration for the issuance of stock,²² the nature of which is in most states indicated by the statutes. If no special provision is made as to the kind and quality of consideration for which no-par stock may be issued, and if the laws of the state indicate the nature of the consideration for which stock shall be issued, the provision would apply both to no-par stock and to stock with par value.²³

The usual statutory provision is that stock may be issued for

²¹ For the form of a resolution authorizing application for listing stock on the New York Stock Exchange, see page 409.

²² Stock issued without consideration was held void in *Kahle v. Stephens*, (1931) 214 Cal. 89, 4 P.(2d) 145. See also *Rice & Hutchins v. Triplex Shoe Co.*, supra (Note 7); *Bryan v. Northwest Beverages*, (1939) 69 N.D. 274, 285 N.W. 689. But stock issued without consideration may nevertheless confer rights as stockholders on bona fide holders for value. *B. & C. Elec. Constr. Co. v. Owen*, (1917) 176 App. Div. 399, 163 N.Y. Supp. 31, aff'd, (1919) 227 N.Y. 569, 126 N.E. 927. See, however, *Kittinger v. Churchill*, (1936) 249 App. Div. 703, 292 N.Y. Supp. 51.

²³ *Cohen v. Beneficial Industrial Loan Corp.*, (1946) 69 F. Supp. 297; *Bodell v. General Gas & Elec. Co.*, supra (Note 1).

money, services, or property.²⁴ This provision does not prevent the corporation from issuing stock as a dividend out of surplus;²⁵ or from issuing a new prior preferred stock in exchange for outstanding preferred and common stock.²⁶

A stock option plan which permits employees to purchase stock at a fixed price requires some consideration, which may be found in the fact that the employee, to exercise his rights in the plan, must continue in the employ of the company.²⁷ Stock issued in satisfaction of a judgment in a consent decree does not meet the requirement, if the judgment satisfied was without adequate consideration of the kind required by the Constitution or statute.²⁸ The corporation, in the absence of a statutory or other express provision to the contrary, may issue stock for property or services,²⁹ provided that the corporation has the express or implied power under its charter to acquire the property taken or contracted to be taken in payment for the stock, and to contract for the labor; and provided further that the action of the corporation in issuing the stock for such consideration is taken in good faith and is not a fraud upon other stockholders or creditors.³⁰

Payment for stock in services. In many states the statutes provide that stock may be issued only for "money paid, labor done, and property actually received." Promotional services, according to the majority rule, are not "labor done" which the corporation can pay for by the issuance of stock.³¹ Nonpromotional services such as legal services

²⁴ *Rice & Hutchins v. Triplex Shoe Co.*, supra (Note 7). Where a corporation is permitted by law to issue stock only for money or property, stock issued for anything else is void. *Thoms v. Sutherland*, (1931) 52 F.(2d) 592.

²⁵ *Gearhart v. Lee-Clay Products Co.*, (1941) 287 Ky. 316, 152 S.W.(2d) 1003; *Whetsel v. Forgey*, (1929) 323 Mo. 681, 20 S.W.(2d) 523.

²⁶ *Topkis v. Delaware Hardware Co.*, (1938) 23 Del. Ch. 125, 2 A.(2d) 14; *Francke v. Axton Fisher Tobacco Co.*, (1942) 289 Ky. 687, 160 S.W.(2d) 23; *Johnson v. Lamprecht*, (1938) 133 Ohio St. 567, 15 N.E.(2d) 127.

²⁷ *Holthusen v. Budd Mfg. Co.*, (1943) 53 F. Supp. 488; *Frankel v. Donovan*, (1956) (Del. Ch.) 120 A.(2d) 311; *Meshel v. Phoenix Hosiery*, (1957) 137 N.Y.L.J. No. 94, p. 6; *Diamond v. Davis*, (1942) 38 N.Y.S.(2d) 103 (N.J. law).

²⁸ *Mudd v. Lanier*, (1945) 247 Ala. 363, 24 So.(2d) 550.

²⁹ *Parrish v. American Ry., etc. Corp.*, (1927) 83 Cal. App. 298, 256 P. 590.

³⁰ *Coffin v. Ransdell*, (1887) 110 Ind. 417, 11 N.E. 20; *Reed & Fibre Products Corp. v. Rosenthal*, (1927) 153 Md. 501, 138 A. 665; *Thomas v. Scoutt*, (1927) 115 Neb. 848, 215 N.W. 140; *New Bern Tire Co. v. Kirkman & Cobb*, (1927) 193 N.C. 534, 137 S.E. 585; *Crumley v. Crumley Business College*, (1927) 120 Ore. 306, 252 P. 85; *Macbeth v. Banfield*, (1904) 45 Ore. 553, 78 P. 693.

³¹ *Du Pont v. Ball*, (1918) 11 Del. Ch. 430, 106 A. 39; *Cooney v. Arlington Hotel Co.*, (1917) 11 Del. Ch. 286, 101 A. 879, mod. on other grounds; *Kimmel Sales Corp. v. Lauster*, (1938) 167 N.Y. Misc. 514, 4 N.Y.S.(2d) 88, and cases cited therein.

in preparing the charter and by-laws, however, have been considered adequate consideration. In other states the effect of the statute is to make the stock voidable rather than void and the defect can be cured by shareholder ratification after full disclosure.³² Any issue to promoters to be valid must be free from fraud and concealment.

There is also some difference of opinion as to whether stock may be issued for services to be rendered in the future. Some cases have held that, under a statute which prohibits the issuance of stock except for money paid, labor done, or property actually received, services to be rendered in the future cannot be a valid consideration for the issuance of fully paid, nonassessable shares.³³ Shares of stock, however, may be issued for services to be rendered so long as they are not marked "fully paid" until the services have been rendered.³⁴ There is some authority that supports the issuance of stock for services to be performed in the future if the transaction is bona fide.³⁵ A corporation cannot legally issue stock to a person upon the sole consideration that that person's name may be used in the corporation,³⁶ that he shall act as president for the ensuing year, or that the corporation shall have the benefit of his business and financial standing.³⁷

Where the validity of the issuance of capital stock for past, present, or future services is recognized, it is, of course, conditioned upon re-

³² Blish v. Thompson Automatic Arms Corp., (1948) 30 Del. Ch. 538, 64 A.(2d) 581, comment, 63 HARV. L. REV. 351; Bryan v. Northwest Beverages Inc., supra (Note 22); Denis v. Nu-Way Puncture Cure Co., (1919) 170 Wis. 333, 175 N.W. 95. All stockholders must be given notice that they will be called on to ratify the issue. Blair v. F. H. Smith Co., (1931) 18 Del. Ch. 150, 156 A. 207. See also State v. Bellin, (1935) 55 R.I. 374, 181 A. 804. As to non-promotional preincorporation services, see Hackney v. York, (1929) (Tex. Civ. App.) 18 S.W.(2d) 923.

³³ Blair v. F. H. Smith Co., supra (Note 32); Scully v. Automobile Finance Co., (1920) 12 Del. Ch. 174, 109 A. 49; Rice & Hutchins v. Triplex Shoe Co., supra (Note 7); Mas Patent Bottle Corp. v. Cox, (1932) 163 Md. 176, 161 A. 243; B. & C. Electrical Constr. Co. v. Owen, supra (Note 22).

³⁴ Scully v. Automobile Finance Co., supra (Note 33).

³⁵ Shannon v. Stevenson, (1896) 173 Pa. St. 419, 34 A. 218, in which it was stated, in dictum, that a proviso that no stock shall be issued "except for money, labor done, or money or property actually received" does not prevent either payment for bona fide labor or services to be thereafter rendered, or contracts to pay in advance for property to be furnished. See also Vogeler v. Punch, (1907) 205 Mo. 558, 103 S.W. 1001; Vine-land Grape Juice Co. v. Chandler, (1912) 80 N.J. Eq. 437, 85 A. 213.

The power of a corporation to compensate its agents and officers for services rendered by the issuance of stock is implied from its power to allow suitable compensation to such agents and officers. Rogers v. Guaranty Trust Co., (1932) 60 F.(2d) 114.

³⁶ Bowen v. Imperial Theatres, (1922) 13 Del. Ch. 120, 115 A. 918.

³⁷ B. & C. Electrical Constr. Co. v. Owen, supra (Note 22).

cept by the corporation of services reasonably worth the face value of the stock given therefor. Principles governing the issuance of capital stock for overvalued property are equally applicable to the issuance of stock for overvalued services.³⁸

In some states in which capital stock is issued for a consideration other than money, the directors are required to state, by resolution, their opinion of the actual value of the consideration, other than money, for which the issue is authorized. Some states require a statement to be filed in the office of a designated state official, setting forth the valuation of the services or property received for stock issued. A resolution should in such cases be passed either by the directors or by those having authority to authorize the issuance of stock, showing the price paid or to be paid for the labor for which the stock is to be issued. It is good practice to present, adopt, and record such a resolution in the minutes of the corporation, even where no formal resolution evaluating the labor done is required by statute.³⁹

Payment for stock in notes. In a few states, the statutes specifically provide that a promissory note shall not be accepted in payment for stock. These statutes apply to stock issued after the corporation is a going concern, as well as to stock issued before organization.⁴⁰ In states where there is no such express prohibition against the acceptance of notes but where the statute provides that stock may be issued only for money, labor done, or property actually received, the courts have differed in their decisions as to whether or not a promissory note can be included in the term "property actually received."⁴¹ Decisions fall, generally, into two groups. In the first group are those cases that regard a note as personal property and hence a valid consideration for the issuance of stock.⁴² In the second group

³⁸ *Chouteau, Harrison & Valle v. Dean*, (1879) 7 Mo. App. 210.

³⁹ See *Bowen v. Imperial Theatres*, *supra* (Note 36).

⁴⁰ *Graves v. Commissioner*, (1953) 202 F.(2d) 286, cert. denied, 346 U.S. 812, 74 S. Ct. 21; *Merchants Bank & Trust Co. v. Walker*, (1942) 192 Miss. 737, 6 So. (2d) 107. See also *State v. Stookey*, 95 Ohio App. 97, 113 N.E.(2d) 254.

⁴¹ See Paskus, "The 'Illegal' Creation of Shares in Return for Notes," 39 YALE L.J. 706; Waterman, "The Creation of Corporate Shares in Return for Promissory Notes," 7 TEXAS L. REV. 215.

⁴² See *Pacific Trust Co. v. Dorsey*, (1886) 72 Cal. 55, 12 P. 49; *Meholin v. Carlson*, (1910) 17 Idaho 742, 107 P. 755; *German Mercantile Co. v. Wanner*, (1913) 25 N.D. 479, 142 N.W. 463; *Empire Holding Corp. v. Coshow*, (1935) 150 Ore. 252, 41 P.(2d) 426; *Schiller Piano Co. v. Hyde*, (1917) 39 S.D. 74, 162 N.W. 937.

are those that ordinarily regard the note merely as a promise to pay and not as property,⁴³ but if something in addition is given with the note, such as the indorsement of a financially responsible person or a valid first mortgage on real estate, the note is considered as property and sufficient consideration to support the issue of stock.⁴⁴ In jurisdictions following the second line of decisions, if the stock is not actually issued and the purchaser is not recognized as a stockholder until after the note has been paid, there is no violation of the provision prohibiting the issuance of stock other than for money, labor done, or property actually received.⁴⁵

Although a note may not be a valid payment for stock, the note and the stock issued for it are not necessarily void.⁴⁶ Inasmuch as the provision in the statute prohibiting the issue of stock for anything but money, services, or property is not intended for the relief of subscribers to whom stock has been issued for their notes, but for the protection of the corporation, its stockholders, and creditors, the notes may be enforced by the corporation against the makers.⁴⁷ However, in at least one jurisdiction, such notes are not enforceable by the corporation or holders who knew that the note was given for stock.⁴⁸

⁴³ *Teehan v. United States*, (1928) 25 F.(2d) 884, states the rule applying in these cases: "It is settled law that, where a statute or a constitutional provision permits a corporation to issue stock only for money paid, services rendered, or property actually received, stock issued for notes of the shareholder is not stock legally issued." See *Graves v. Commissioner*, supra (Note 40); *Lepanto Gin Co. v. Barnes*, (1930) 182 Ark. 422, 31 S.W.(2d) 746; *Sohland v. Baker*, (1927) 15 Del. Ch. 431, 141 A. 277. See also *Bank of Commerce v. Goolsby*, (1917) 129 Ark. 416, 196 S.W. 803; *Lofland v. Cahall*, (1922) 13 Del. Ch. 384, 118 A. 1; *Arndt v. Abbott*, (1941) 308 Ill. App. 633, 32 N.E.(2d) 342; *Shafer v. Home Trading Co.*, (1932) 227 Mo. App. 347, 52 S.W.(2d) 462; *Southwestern Tank Co. v. Morrow*, (1925) 115 Okla. 97, 241 P. 1097; *Dunagan v. Bushey*, (1952) 152 Tex. 630, 263 S.W.(2d) 148.

⁴⁴ *Harn v. Smith*, (1922) 85 Okla. 137, 204 P. 642; *General Bonding & Cas. Ins. Co. v. Moseley*, (1920) 110 Tex. 529, 222 S.W. 961; *Opinion, Attorney General, Texas*, to Secretary of State, 4-25-47, No. V-163. *Contra*: *Graves v. Commissioner*, supra (Note 40).

⁴⁵ *Smith v. McAdams*, (1918) (Tex. Civ. App.) 206 S.W. 955. Stock must be issued and actually or constructively received by the subscriber to constitute him a stockholder. *Corporation Comm'r v. Harris*, (1929) 197 N.C. 202, 148 S.E. 174.

⁴⁶ *Joy v. Godchaux*, (1929) 35 F.(2d) 649; *Teehan v. U.S.*, supra (Note 43); *Cahall v. Lofland*, (1921) 12 Del. Ch. 299, 114 A. 224, aff'd 13 Del. Ch. 384, 118 A. 1; *Grange Nat'l Bank v. Collman*, (1931) 103 Pa. Super. 235, 158 A. 195. But see *General Beverages Inc. v. Rogers*, (1954) 216 F.(2d) 413.

⁴⁷ *Theunissen v. Continental Trust Co.*, (1926) 15 F.(2d) 894. See *Backus v. Hutson*, (1930) 136 N.Y. Misc. 290, 240 N.Y. Supp. 610, in which a note given for stock was held enforceable against the maker by the trustee in bankruptcy.

⁴⁸ *Western Nat'l Bank v. Spencer*, (1922) 112 Tex. 49, 244 S.W. 123.

Payment for stock in property. In each state the constitution or the statute, directly or indirectly, sanctions the issuance of capital stock for property. These provisions differ in their requirements regarding: (1) the kinds of property that the corporation may accept in payment for stock; (2) the procedure to be followed in authorizing the issuance of stock for property; (3) the method of valuing the property; and (4) the liability resulting from the issuance of stock for overvalued property.

Kinds of property acceptable in payment of stock. In a few states the statutes indicate that real and personal property may be received in payment for stock; in others, in addition to real and personal property, such property as mining rights, patent rights, rights of way, goodwill, and contracts are specifically made acceptable. If the statutes do not expressly enumerate the kinds of property that the corporation may accept for its stock, it is generally held that the corporation may accept real or personal property. Such property, however, must be of the kind that the corporation has the power to acquire and hold in carrying out the objects and purposes for which it was organized; or it must be of the kind in which the corporation is authorized by statute to invest its funds.⁴⁹ Patents,⁵⁰ trade marks,⁵¹ formulas,⁵² applications for patents, mines, leases,⁵³ and the assignments of contracts⁵⁴ are a few kinds of property that may be received.

A waiver of contractual rights can be a sufficient consideration for the issuance of stock.⁵⁵ A license to use certain trade-marks that is con-

⁴⁹ *Harn v. Smith*, (1922) 85 Okla. 137, 204 P. 642.

⁵⁰ *West v. Sirian Lamp Co.*, (1941) 28 Del. Ch. 90, 37 A.(2d) 835, s.c., (1945) 28 Del. Ch. 328, 42 A.(2d) 883, 28 Del. Ch. 398, 44 A.(2d) 658; *Atlas Trailers and Water Mufflers v. McCallum*, (1929) 118 Tex. 173, 12 S.W.(2d) 957. But worthless patents are not considered "property." *Edgerton v. Electric Improvement & Constr. Co.*, (1892) 50 N.J. Eq. 354, 24 A. 540.

⁵¹ *Brown v. Weeks*, (1917) 195 Mich. 27, 161 N.W. 945.

⁵² *Murray v. Murray Laboratories*, (1954) 223 Ark. 907, 270 S.W.(2d) 927. But unpatentable formulas, and formulas and processes with no substantial value, are not sufficient consideration. *Trotta v. Metalmold*, (1953) 139 Conn. 668, 96 A.(2d) 798; *Webster v. Okmulgee Webster Refining Co.*, (1912) 36 Okla. 168, 128 P. 261; *O'Bear-Nester Glass Co. v. Antiexplo Co.*, (1908) 101 Tex. 431, 109 S.W. 931.

⁵³ *Seches v. Bard*, (1931) 67 Cal. App. 374, 4 P.(2d) 167; *McAlister v. Eclipse Oil Co.*, (1936) 128 Tex. 449, 98 S.W.(2d) 171.

⁵⁴ *Anisow v. Potter*, (1937) 22 Del. Ch. 138, 193 A. 926; *Miller v. Youmans-Burke Oil & Gas Co.*, (1937) 278 Mich. 647, 270 N.W. 819.

⁵⁵ *Burge v. Midway Pacific Oil Co.*, (1929) 99 Cal. App. 714, 279 P. 181; 28 MICH. L. REV. 1048. The *Burge* case held that an extension of the due date of a mortgage was sufficient consideration for the issuance of stock. Similarly, the conveyance of an equity

siderably broader than a prior license is valid consideration for stock.⁵⁶ The fact that the corporation, in the future, may have to spend some money to protect its rights in property acquired in exchange for stock does not necessarily make the consideration invalid.⁵⁷

Although property accepted in payment for stock need not have a market value, nevertheless, in order to constitute a satisfactory consideration for the issuance of stock, it must have a commercial value.⁵⁸ The directors, by a pretended exercise of judgment, cannot give a value to that which has no value.⁵⁹ For example, the directors cannot issue stock for a business idea that is not salable or transferable, that is, an idea which others have used and that anyone can use freely. Such an idea, having no commercial value, cannot be a consideration for stock.⁶⁰ The goodwill of a business may be accepted in payment of stock, but the goodwill must have value.⁶¹ There is no value in the goodwill of a business that has never been profitable, even if the business when taken over is a going concern.⁶²

If the corporation has the power to hold stock in other corporations, it may accept such stock in payment for its own shares,⁶³ provided that the stock to be received is not worthless.⁶⁴ Receipt by a corporation of shares of its own stock has been held to be adequate consideration.⁶⁵

in mortgaged property to avoid litigation expense is also sufficient. *Morris v. North Evanston Manor Bldg. Corp.*, (1943) 319 Ill. App. 289, 49 N.E.(2d) 646.

⁵⁶ *Sarasohn v. Andrew Jergens Co.*, (1943) 45 N.Y.S.(2d) 888.

⁵⁷ *West v. Sirian Lamp Co.*, supra (Note 50).

⁵⁸ *Kunkle v. Soule*, (1920) 68 Colo. 524, 190 P. 536.

⁵⁹ *Scully v. Automobile Finance Co.*, supra (Note 33); *Ellis v. Penn Beef Co.*, (1911) 9 Del. Ch. 213, 80 A. 666. But, it has been held, equal value, dollar for dollar, need not be received in property for stock. It is sufficient if the amount received reasonably approximates the amount of stock issued. *Park v. Compton*, (1932) 55 F.(2d) 80.

⁶⁰ *Scully v. Automobile Finance Co.*, supra (Note 33).

⁶¹ A contract under which stock was issued in consideration of an agreement not to sell certain photographic paper in designated countries, was upheld where the restrictive covenant was incidental to sale of the business. *Thoms v. Sutherland*, supra (Note 24).

⁶² *Linden Bros. v. Practical Electricity & Engineering Publishing Co.*, (1923) 309 Ill. 132, 140 N.E. 874; *William E. Dee Co. v. Proviso Coal Co.*, (1919) 290 Ill. 252, 125 N.E. 24. Moreover, the goodwill, prestige, and influence of subscribers in assisting in selling stock to the public is not sufficient consideration. *Laing v. Hutton*, (1932) 138 Ore. 307, 6 P.(2d) 884.

⁶³ *Southern Trust & Deposit Co. v. Yeatman*, (1905) 134 F. 810.

⁶⁴ *Loring v. Lamson & Hubbard Corp.*, (1924) 249 Mass. 272, 143 N.E. 916.

⁶⁵ *Savic v. Karmlich*, supra (Note 1).

A corporation may discharge its indebtedness to a subscriber to whom it has issued its stock by writing off the indebtedness on its books, and crediting the amount to the subscriber in payment for his stock. To effect this result it is not necessary to go through the formality of having the subscriber pay for his stock and the corporation return to him a sum sufficient to discharge the indebtedness.⁶⁶

Procedure in authorizing issuance of stock for property. In authorizing the issuance of stock for property, and in valuing the property to be received for the stock, the corporation must follow the statutory procedure laid down in the laws of the state in which the corporation is organized. In addition, pertinent charter and by-law provisions must be observed. The laws of many states require the corporation that issues its capital stock for property to keep certain records, showing the nature of the property taken for stock and its value. In several of the states, a certificate must be filed with the Secretary of State, or some other designated official, whenever stock is to be issued for a consideration other than cash. Substantial compliance with such provisions is required.

Ordinarily authority to value property and issue stock for it is vested under the statute or charter in the board of directors; in such case only the board can act in the matter. The minutes of the directors' meeting should contain an entry of the valuation of the property. However, failure to include such a record of the transaction will not invalidate it if appropriate corporate action was taken.⁶⁷

When the corporation is being organized, the incorporators, directors, or stockholders, at their first meeting, may consider offers to exchange property for stock of the proposed corporation. However, if the meeting is being held by dummy incorporators or directors, it is not advisable to have such matters as contracts for the corporate purchase of property for stock, passed upon at the meeting; the consideration and vote upon such contracts should be postponed to a meeting participated in by the real incorporators, stockholders, or directors.

⁶⁶ *Rodgers v. H. S. Kerbaugh, Inc.*, (1921) 190 N.Y. Supp. 245.

⁶⁷ *Whitlock v. Alexander*, (1912) 160 N.C. 465, 76 S.E. 538. See also *East Lake Lumber Co. v. Van Gorder*, supra (Note 8), leave to appeal denied, 189 App. Div. 884, 177 N.Y. Supp. 914. But see *Bowen v. Imperial Theatres*, supra (Note 36).

Method of valuing property received for stock. The issuance of stock for property always involves a valuation of the property to be acquired in exchange for the stock. The corporation laws or the constitution of most of the states indicate the method of valuing property for the purpose of issuing stock for it. The most usual statutory provision is that the corporation may issue stock in the amount of the value of the property taken in payment, the judgment of the directors as to the value of the property purchased to be conclusive, in the absence of fraud in the transaction. Other statutory provisions permit the acquisition of property at: (1) its reasonable value; (2) its actual value; (3) a bona fide and fair value; (4) its actual cash value; (5) its true money value; or (6) a value deemed by the directors to be at least equal to the full par value of the stock to be issued.⁶⁸

Under the usual statutory provision, that the judgment of the directors as to the value of the property is conclusive in the absence of fraud, a stockholder is protected from demands for further payment on account of stock acquired by him in exchange for property. He must, however, show that his property was accepted by the corporation in payment for his stock, at a valuation determined by the board of directors. This protection is lost only when actual fraud in the transaction is shown by one who alleges that the stockholder has not paid for his stock in money or money's worth.⁶⁹ The directors, in exercising their judgment as to the value of property taken in exchange for stock, which judgment is to be regarded as conclusive, must make an honest attempt to determine the value of the property; they must act in the interests of the corporation and secure for the corporation everything to which it is entitled. Anything less than this is dishonest and fraudulent.⁷⁰ Thus a conscious overvaluation by the directors constitutes fraud.⁷¹ The directors may exercise very poor judgment, or they may make a mistake in the valuation of

⁶⁸ *Compton v. Perkins*, (1933) 144 Ore. 346, 24 P.(2d) 670.

⁶⁹ *New Bern Tire Co. v. Kirkman & Cobb*, *supra* (Note 30). See also *Lamprecht v. Swiss Oil Corp.*, (1929) 32 F.(2d) 646; *Sokoloff v. Wildwood Pier & Realty Co.*, (1931) 108 N.J. Eq. 362, 155 A. 125.

⁷⁰ *Rugger v. Mt. Hood Electric Co.*, (1933) 143 Ore. 193, 20 P.(2d) 412; *Atwell v. Schmitt*, (1924) 111 Ore. 96, 225 P. 325. Directors can not delegate this responsibility to an independent appraiser but they can employ assistance in their appraisal. *Field v. Carlisle Corp.*, (1949) 31 Del. Ch. 227, 68 A.(2d) 817.

⁷¹ *Scully v. Automobile Finance Co.*, *supra* (Note 33).

the property; but if, in so doing, they act fairly and honestly and not in furtherance of their own interests, the valuation they arrive at is conclusive.⁷² Property is not considered overvalued merely because it subsequently turns out to be so, if the valuation has been made in good faith.⁷³

Tests to determine accuracy of valuation of property received for stock. The valuation fixed by the directors for property accepted by the corporation in payment for its capital stock must meet the tests applied by the courts in passing upon the sufficiency of the value given the property. In testing the value determined by the directors, two rules, the "true value" rule and the "good faith" rule have been developed. Which of these rules shall be applied in testing the valuation depends upon the court decisions in the state in which the corporation issuing the stock is organized.

Where the true value rule is followed, an objective standard is set up. The motive, intent, or good faith of the directors, or others making the valuation, is immaterial. To be relieved from liability, the subscriber must show that the property conveyed to the corporation in payment of the subscription was worth the face or fixed value of the shares at the time they were issued.⁷⁴

Where the good faith rule is followed, a subjective standard is set up. It is the presence or absence of good faith on the part of the directors, or others making the valuation, that determines the sufficiency or insufficiency of the value fixed. The difficulty encountered in applying the good faith rule is in determining what constitutes good faith.⁷⁵ Some of the decisions hold that, in the absence of an

⁷² Where the directors have no personal interest antagonistic to the corporation, their estimates of the value of the property exchanged for stock are entitled to just consideration. *Compton v. Perkins*, *supra* (Note 68).

⁷³ *Smith v. Schmitt*, (1924) 112 Ore. 687, 231 P. 176. See also *H. B. Humphrey Co. v. Pollack Roller Runner Sled Co.*, (1932) 278 Mass. 350, 180 N.E. 164.

⁷⁴ See, for example, *Detroit-Kentucky Coal Co. v. Bickett*, (1918) 251 F. 542; *Tramp v. Marquesen*, (1920) 188 Iowa 968, 176 N.W. 977; *Lavell v. Bullock*, (1919) 43 N.D. 135, 174 N.W. 764. The true value rule was largely applied only in cases involving claims of creditors, and has now been abandoned in most states formerly following it. See, for example, *Strickland v. Washington Bldg. Corp.*, (1936) 287 Ill. App. 340, 4 N.E.(2d) 973.

⁷⁵ *Coit v. Gold Amalgamating Co.*, (1886) 119 U.S. 343, is the leading case. See also *Clinton Mining & Mineral Co. v. Jamison*, (1919) 256 F. 577. This rule was applied in *Caldwell v. Robinson*, (1920) 179 N.C. 518, 103 S.E. 75; and *Winters v. Lindsay*, (1921) 52 Cal. App. 93, 198 P. 43.

affirmative showing of fraud, mere overvaluation of the property given in exchange for stock will not render the stockholder liable for the difference between the amount paid and the value of the stock received; whereas others hold that gross overvaluation itself constitutes, or at least raises a strong presumption of, fraud.⁷⁶ An affirmative showing of fraud will render the stockholder liable for the difference between the amount paid and the value of the stock received.

Liability of directors upon issuance of stock for overvalued property. In some states, the statutes impose a personal liability upon directors who participate in the issuance of stock for overvalued property. Where these laws are in force, the corporate minutes should record the names of the directors voting for the issuance of stock for property at the value fixed. If the law also provides that directors, in order to escape personal liability for the acts of their fellow directors in authorizing the issuance of stock for overvalued property, must enter their dissent from the valuation in writing, the dissents should appear in the minutes.

Obligations of corporation upon issuance of stock for overvalued property. A corporation that has issued stock as fully paid, without getting full value for it, under an agreement not to require further payment, cannot afterward repudiate the contract, if there is no statutory or charter provision declaring such a transaction void, and if the stockholders have unanimously consented to the issue.⁷⁷ The corporation cannot exclude holders of the stock from participating in the company's affairs. Nor can it compel them to pay the difference between the face value of the stock and what has been paid or agreed upon as full payment.

In some states, the statutes prohibit fictitious increases of stock and declare all such increases void. Courts applying such provisions have held void stock issued purely as a gratuity, and have denied to the persons receiving such stock any rights against the corporation.⁷⁸ If

⁷⁶ *State Trust Co. v. Turner*, (1900) 111 Iowa 664, 82 N.W. 1029.

⁷⁷ *Scovill v. Thayer*, supra (Note 5); *In re Associated Oil Co.*, (1923) 289 F. 963 (S.D. law); *Ackerman Tool & Constr. Co. v. McArthur*, (1954) (La.) 73 So. (2d) 507; *Grants Pass Hardware Co. v. Calvert*, (1914) 71 Ore. 103, 142 P. 569; *Vasey v. New Export Coal Co.*, (1921) 89 W. Va. 491, 109 S.E. 619. Compare *Cooney v. Arlington Hotel Co.*, supra (Note 31).

⁷⁸ *Clark v. Millsap*, (1926) 197 Cal. 765, 242 P. 918; *J. F. Lucey Co. v. McMullen*,

some value has been given for the stock the portion of the stock in excess of the payment received is fictitious and voidable at the suit of the corporation.⁷⁹ However, one case, decided under statutes declaring all fictitious increases of stock void, held that stock issued for overvalued property is valid and denied the right to question the adequacy of the consideration.⁸⁰

Rights of subscribers and stockholders upon issuance of stock for overvalued property. A stockholder who has paid full value for his shares, or a subscriber who undertakes to pay for his shares in full, has the right to assume that every other stockholder or subscriber has paid or will pay a full consideration for his stock. However, a stockholder who assents to an issue of stock for payment not equal to the value of the shares cannot complain against the issue of the fictitiously paid-up stock.⁸¹ Nor can he complain, if, with knowledge of the facts, he does not object to the transaction within a reasonable time.⁸² If a stockholder has not voluntarily assented to or acquiesced in an issuance of fully paid shares for a consideration less than par, or for property not equal in value to the stock issued therefor, he may file a bill to annul the entire transaction;⁸³ or, in some jurisdictions, if the issue has been made in violation of the constitution or statute, he can compel the surrender for cancellation of all stock in excess of the value paid.⁸⁴ A stockholder who dissents to a proposal to issue stock for less than its full value may enjoin the corporation from issuing the stock, if the proposed transaction violates the rights of

(1918) 178 Cal. 425, 173 P. 1000; *L. J. Mueller Furnace Co. v. Holmes*, (1921) 175 Wis. 518, 185 N.W. 641; *Thornson v. Universal Mfg Co.*, (1916) 164 Wis. 44, 159 N.W. 575. See also *Wells v. Comstock*, (1956) 46 Cal. (2d) 528, 297 P.(2d) 961.

⁷⁹ *Rice v. Thomas*, (1919) 184 Ky. 168, 211 S.W. 428; *Taylor v. Citizens' Oil Co.*, (1918) 182 Ky. 350, 206 S.W. 644.

⁸⁰ *Microsi v. Irvine*, (1893) 102 Ala. 648, 15 So. 429.

⁸¹ *In re Charles Town Light & Power Co.*, (1912) 199 F. 846; *Vasey v. New Export Coal Co.*, *supra* (Note 77). In cases where all the stockholders have assented to corporate action, and no rights of the state or creditors intervene, the doctrine of estoppel is fully applicable. *Gill v. Wading River Realty Co.*, (1931) (N.J. Ch.) 157 A. 840.

⁸² *Taylor v. S. & N. Alabama R.R.*, (1882) 13 F. 152; *Keeney v. Converse*, (1894) 99 Mich. 316, 58 N.W. 325.

⁸³ *Perry v. Tuscaloosa Cotton-Seed Oil-Mill Co.*, (1891) 93 Ala. 364, 9 So. 217; *Fisk v. Chicago, R. I. & P. R.R.*, (1868) 53 Barb. (N.Y.) 513; *Voorhees v. Mason*, (1910) 245 Ill. 256, 91 N.E. 1056.

⁸⁴ *Rice v. Thomas*, *supra* (Note 79); *Taylor v. Citizens Oil Co.*, *supra* (Note 79).

existing stockholders, or the provisions of the constitution, the statute, or the corporation's charter.⁸⁵

If the overvaluation of property received by the corporation is the product of fraud on the part of the directors, or others authorizing the issuance of the stock, stockholders who have paid for their stock in full can compel holders of the watered stock to pay the difference between the amount actually paid for the stock in property, and the par value or value that should have been received in return for the stock.⁸⁶

Liabilities of holders of watered stock to creditors. A stockholder who holds watered stock of an insolvent corporation is generally liable to the corporation's creditors for an amount equal to the aggregate par value of his shares minus the value of the consideration paid to the corporation for the shares.⁸⁷ This liability has been established on such theories as fraud, trust, statutory obligation, and implied contract.⁸⁸ Since the liability of stockholders for watered stock is governed by the law of the state in which the corporation is organized,⁸⁹

⁸⁵ *American Alkali Co. v. Campbell*, (1902) 113 F. 398; *Donald v. American Smelting & Refining Co.*, (1901) 62 N.J. Eq. 729, 48 A. 771, 1116.

⁸⁶ *Camden v. Stuart*, (1892) 144 U.S. 104, 12 S. Ct. 585. But see *Wells v. Comstock*, *supra* (Note 78).

⁸⁷ *Scovill v. Thayer*, *supra* (Note 5); *In re Caledonia Coal Co.*, (1918) 245 F. 742; *Du Pont v. Ball*, *supra* (Note 31); BALLANTINE, CORP. §350, rev. ed. 1946; 13 FLETCHER, CORPORATIONS §6051, 1942; Bonbright, "Shareholders' Defenses Against Liability to Creditors on Watered Stock," 25 COLUM. L. REV. 408.

⁸⁸ The leading fraud theory case is *Hospe v. Northwestern Mfg. & Car Co.*, (1892) 48 Minn. 174, 50 N.W. 1117, which held that it is a fraud on the creditor to have issued par value stock which the corporation has not received full value for.

Scovill v. Thayer, *supra* (Note 5) is the landmark trust fund case. This theory, but not its result, has been widely criticized and almost everywhere ignored or abandoned. See *Hospes v. Northwestern Mfg. & Car Co.*, *supra*.

The statutory obligation basis for liability for watered shares grounds liability on an inference that a statute or constitutional provision providing for full consideration for par value shares may be construed to mean that holders of shares will be liable if this value is not paid. *Easton Nat'l Bank v. American Brick & Tile Co.*, (1906) 70 N.J. Eq. 732, 64 A. 917. But many courts have interpreted such statute to be merely a codification of the common law fraud theory. *Bing Crosby Minute Maid Corp. v. Eaton*, (1956) 46 Cal. (2d) 484, 297 P.(2d) 5, criticized in 44 CALIF. L. REV. 941 for failure of California Supreme Court to follow the "statutory obligation" theory; *Collier v. Edwards*, (1924) 109 Okla. 153, 234 P. 720. See also *Stone v. Hudgens*, (1955) 129 F. Supp. 273, criticized in 54 MICH. L. REV. 281.

In *Du Pont v. Ball*, *supra* (Note 31), the court held that, as against creditors, there was an implied contract to pay the par value of the shares where there was a constitutional provision making watered stock void.

⁸⁹ *Speakman v. Bernstein*, (1932) 59 F.(2d) 520.

differences in decisions and rulings may often be explained by the particular theory prevailing in that state.⁹⁰

The creditors' right to compel holders of watered stock to make up the deficiency is not impaired even though there is a valid agreement between a stockholder and the corporation under which fully paid and nonassessable stock is issued for a consideration less than its full value. Such an agreement has been held binding as against the corporation, but void as to the creditors.⁹¹ A creditor, however, in order to be entitled to this right, must have given credit on the faith that the stock was fully paid.⁹² A creditor who became so before the watered or fictitiously paid up stock was issued cannot compel the holders of such stock to pay for their shares in full.⁹³ Likewise, a creditor who knew that stock had been issued for less than its consideration, generally cannot require the holders of the watered stock to pay the full value of the shares.⁹⁴ But in some jurisdictions, creditors are able to recover the unpaid stock, even though they have knowledge of the circumstances under which the unpaid stock was issued as full paid.⁹⁵

Rights of transferees of overvalued stock. If transferees have knowledge that stock issued as fully paid is in fact watered, or knowledge of facts sufficient to put them on notice of the true state of affairs, they have no right, as against the corporation, to compel it to issue to them a new certificate stamped "fully paid and non-assessable."⁹⁶ Because a transferee stands in the shoes of his transferor,

⁹⁰ Under the fraud theory there must be reliance, presumed or actual, and there can be no reliance if the credit is extended prior to the issuance of the watered stock. Under the statutory obligation and the contractual theory, reliance is immaterial. See *Du Pont v. Ball*, supra (Note 31); *Atwell v. Schmidt*, (1924) 111 Ore. 96, 225 P. 325.

⁹¹ *Scovill v. Thayer*, supra (Note 5); *Courtney v. Georger*, (1915) 228 F. 859.

⁹² Liability here is based upon the so-called fraud or misrepresentation theory. In *Hospe v. Northwestern Mfg. & Car Co.*, supra (Note 88) reliance by the creditor on the issued par value stock being fully paid is conclusively presumed. See also *Collier v. Edwards*, supra (Note 88). But Compare *Bing Crosby Minute Maid Corp. v. Eaton*, supra (Note 88), comment, 55 MICH. L. REV. 719 and STAN. L. REV. 191, which held that actual reliance must be proved under the fraud or misrepresentation theory. See also *Handley v. Stutz*, (1890) 139 U.S. 417, for a rebuttable presumption of reliance.

⁹³ *Handley v. Stutz*, supra (Note 92).

⁹⁴ *Coit v. Gold Amalgamating Co.*, (1886) 119 U.S. 343. See also 25 COLUM. L. REV. 421.

⁹⁵ *Du Pont v. Ball*, supra (Note 31); *Eastern Nat'l Bank v. American Brick & Tile Co.*, supra (Note 88); *Atwell v. Schmidt*, supra (Note 90).

⁹⁶ *Bowen v. Imperial Theatres, Inc.*, (1922) 13 Del. Ch. 120, 115 A. 918.

if the latter had no cause of complaint against the corporation, the former has none, and his knowledge or want of knowledge regarding the fictitious nature of the stock issue makes no difference.⁹⁷

Transferees without knowledge that stock issued as fully paid and nonassessable was issued for overvalued property or for property that did not constitute legal payment, cannot be made liable to the corporation for the difference between the consideration given for the stock and its full value. The corporation is said to be estopped from asserting any rights against the transferees of its watered or fictitiously paid-up stock.⁹⁸ On the other hand, no estoppel operates if the transferees had notice that the stock was issued for overvalued property, and the corporation may recover in an action against them.⁹⁹ Some courts have held that if the statute declares that illegally issued stock is void, transferees without notice are subject to cancellation of their stock in a suit by the corporation.¹⁰⁰ One state court has, however, ruled that transferees without notice that the stock was illegally issued, held their stock free from the effect of a constitutional provision declaring fictitious increases of stock void.¹⁰¹

A defrauded transferee of overvalued stock who holds a certificate marked "fully paid and nonassessable" that is not so in fact, may maintain an action for damages against those from whom he purchased the stock and against the corporation, if it was a party to the fraud.¹⁰²

Liabilities of transferees of watered stock to creditors. A transferee of watered stock who has knowledge that the stock issued as fully paid is in fact paid less than its full value is liable to the creditors of the issuing corporation for the unpaid balance.¹⁰³ But if he has no

⁹⁷ *Church v. Citizens' St. R.R.*, (1897) 78 F. 526; *Wood v. Corry Water-Works Co.*, (1890) 44 F. 146.

⁹⁸ *Bowen v. Imperial Theatres, Inc.*, *supra* (Note 96).

⁹⁹ *Jose v. Utley*, (1921) 185 Cal. 656, 199 P. 1037.

¹⁰⁰ *Lee v. Cameron*, (1917) 67 Okla. 80, 169 P. 17; *Walton v. Standard Drilling Co.*, (1921) 43 S.D. 576, 181 N.W. 96.

¹⁰¹ *Taylor v. Citizens' Oil Co.*, *supra* (Note 79). See *Maclary v. Pleasant Hills, Inc.*, (1954) (Del. Ch.) 109 A.(2d) 830, holding that where stock has been issued without consideration but the equities favor the stockholder, the stockholder will be given the election of retaining the stock on payment of a fair price. See also Comment, "Stockholders' Liability Upon Unpaid and Watered Stock," 24 TENN. L. REV. 584.

¹⁰² *Fosdick v. Sturges*, (1858) 1 Biss. (U.S.) 255.

¹⁰³ But the transferee with knowledge is not liable if there has been an intervening innocent purchaser. *Graham v. Fleissner's Ex'rs*, (1931) 170 N.J.L. 278, 153 A. 526.

such knowledge, or if such knowledge is not imputable to him, he cannot be held accountable.¹⁰⁴ In this event, the original holder of the stock or the transferor remains liable to the creditors.¹⁰⁵

Amount of consideration for par value stock. The general rule is that if stock has a par value fixed by the corporate charter or by general law, the price at which the stock is to be sold must be at least equal to the par value of the stock. The statutes or the constitution in some states specifically requires that the consideration to be paid for capital stock shall be equal in amount to the par value of the stock. In other states, however, the statutes permit the board of directors or stockholders to fix a price for the stock at less than its par value. If neither the statute, constitution, nor charter of the corporation expressly requires that stock be paid for at its par value, a corporation may make a valid agreement with its subscribers for the sale of stock at less than par value, and it may issue fully paid stock upon the payment of the price agreed upon, provided that the rights of the other stockholders are not violated and that there is no fraud against creditors. As between the corporation and the subscriber, the agreement is valid, and the corporation cannot maintain a suit to collect the difference between the par value and the amount paid upon the stock for which the fully paid certificates have been issued.¹⁰⁶ But such a contract, while binding on the corporation, will not be binding on creditors; when the rights of creditors are to be satisfied, the stockholders who have paid less than par for their shares may be required to pay for their stock in full.

A going concern in need of capital, whose stock has fallen below par value, will of course find difficulty in selling its unissued stock at par. In practice, the corporation will market its shares for the best price that can be obtained. So long as the transaction is bona fide, and the consideration obtained represents the actual value of the stock, the courts generally will not disturb the transaction; in the absence

¹⁰⁴ *Enright v. Heckscher*, (1917) 240 F. 863; *Rhode v. Dock-Hop Co.*, (1920) 184 Cal. 367, 194 P. 11; *Gray Constr. Co. v. Fantle*, (1934) 62 S.D. 345, 253 N.W. 464.

¹⁰⁵ *Palmer v. Scheftel*, (1921) 194 App. Div. 682, 186 N.Y. Supp. 84, aff'd, memo dec., 236 N.Y. 511, 142 N.E. 263.

¹⁰⁶ *Scovill v. Thayer*, supra (Note 5); *Bacich v. Northland Transp. Co.*, (1932) 185 Minn. 544, 242 N.W. 379.

of fraud, the purchaser will be liable only for the contract price.¹⁰⁷ Creditors cannot recover the difference between the contract price and the par value of the stock without proof of bad faith on the part of those entering into such a transaction, and without showing that the stock of the corporation, when issued under such circumstances, had in fact a higher actual value at the time of its issuance than that at which the stock was sold.¹⁰⁸

The corporation may fix a price for its stock above the par value thereof. A subscription contract at such a price is valid, and the subscriber, in order to become entitled to a fully paid, nonassessable stock certificate,¹⁰⁹ is obligated to pay both the par value of the stock and the premium fixed.

Amount of consideration for no-par shares. In practically all of the states, the laws authorizing corporations to issue shares of capital stock without par value indicate the manner of determining the amount of consideration to be paid for such shares. The most usual provision is that no-par shares may be issued for such consideration as may be prescribed in the charter or an amendment; or, if there is no provision in this respect, then for such consideration as may be fixed by the stockholders at a meeting duly called for that purpose, or as may be fixed by the directors, acting under general or special authority granted by the stockholders or conferred by the certificate of incorporation. The practice generally followed in the organization of corporations having no-par shares is to include in the charter of the corporation a provision that the directors shall have the power to determine from time to time the consideration to be received for stock without par value.¹¹⁰ The action of directors or stockholders in fixing the price at which no-par stock shall be sold may be subject to the approval of public service commissions, blue-sky commissions, or other regulating bodies. In some states, before the corporation may issue its stock,¹¹¹ it is required to file an affidavit with a designated

¹⁰⁷ *Handley v. Stutz*, supra (Note 92); *Morrow v. Nashville Iron & Steel Co.*, (1889) 87 Tenn. 262, 10 S.W. 495. See also *Fogg v. Blair*, (1890) 139 U.S. 118; *J. F. Lucey Co. v. McMullen*, supra (Note 78).

¹⁰⁸ *Ibid.*

¹⁰⁹ *Grono v. Economic Life Ins. Co.*, (1911) (Del. Ch.) 80 A. 809.

¹¹⁰ *Lewis v. Oscar C. Wright Co.*, supra (Note 1).

¹¹¹ Such a provision may apply to issues of par value stock as well as to no-par value stock.

state authority, showing the financial plan under which stocks are to be issued.

In exercising their power to fix the price at which shares of no-par value stock are to be sold, the directors are given practically unlimited latitude. The statutes provide no measure of the amount of consideration to be fixed. Within the authority conferred by the articles or certificate of incorporation, the board of directors may fix the price at its real, market, or book value, or at a minute or arbitrary figure, subject to review by a court of equity.¹¹²

In fixing the sale price of no-par shares, the directors should be guided as honest and fair-minded men by all legitimate considerations under the particular conditions surrounding the transaction. These considerations include the appraised and sale value of the corporate assets, book values, market values of outstanding shares, present and probable earning power, market conditions, the size of the issue, and the reputation of the corporation. The decision of the directors will also depend upon whether or not the stock is issued by a corporation recently formed or by an established corporation. In the former case, it matters little how much or how little is received in consideration of the corporation's original issue of no-par stock;¹¹³ in the latter case, the price at which stock is sold is of considerable importance to existing stockholders. Existing no-par stockholders share in the total net assets of the company; therefore, if a new issue of no-par stock is sold for less than the actual value of the existing shares, it will dilute the interest of the existing no-par share-

¹¹² *Bodell v. General Gas & Elec. Corp.*, supra (Note 1); *Rice & Hutchins, Inc. v. Triplex Shoe Co.*, supra (Note 7); Compare *G. Loewus & Co. v. Highland Queen Packing Co.*, (1939) 125 N.J. Eq. 534, 6 A.(2d) 545. See *Sieb's Hatcheries, Inc. v. Lindley*, (1952) 108 F. Supp. 415. See also Bonbright, "The Dangers of Shares Without Par Value," 24 COLUM. L. REV. 449; Berle, "Problems of Non-Par Stock," 25 COLUM. L. REV. 43; Morawetz, "Shares Without Nominal or Par Value," 26 HARV. L. REV. 729; *Israels*, "Problems of Par and No-Par Shares: A Reappraisal," 47 COLUM. L. REV. 1279.

¹¹³ If the total amount for the issue is fixed, for example, at \$100,000, so long as \$100,000 is received, it does not matter if five, ten, or one thousand shares are given for it. Even if no par value shares are given a nominal value, it is no indication of their actual value any more than is the par value of shares an indication of their actual value. *Chadwick v. McClurg*, (1928) 103 N.J. Eq. 55, 142 A. 173. The entire issue may be of no par value stock. *Land Development Co. v. Jordan*, (1926) 198 Cal. 346, 245 P. 187.

If the board accepts an offer to transfer property for a certain number of shares of no par stock, the board thereby fixes the amount of consideration for the no par stock. *Rose Theater, Inc. v. Jones*, (1955) 224 Ark. 951, 278 S.W.(2d) 105.

holders in the total corporate assets by that amount by which the sale price of the new issue is less than the actual value of existing no-par shares. Equity may therefore interfere to protect existing stockholders where the price of a new issue affects the values of their holdings. Existing stockholders should be given at least a prior right to subscribe to the new issue (see page 913, et seq.).

Sale of shares of same issue of no-par value stock to different subscribers at different prices. Generally the directors, in marketing an issue of no-par value stock, upon the shares of which they have set a fixed price, cannot sell different lots or blocks of stock of this same issue to different buyers at different prices, but are required to maintain one price for all. In the rigid application of this rule, practical difficulties may arise from conditions existing in the market, and the directors may be forced to disregard the rule. This action may be justified by circumstances, and if it is fair and for the best interests of the corporation, it will be sustained by the courts.¹¹⁴

Amount of consideration for treasury stock. Treasury stock is capital stock which has been legally issued, fully paid for, and then returned to the treasury of the corporation by purchase or otherwise, to be disposed of for the benefit of the corporation.¹¹⁵ In the disposition of treasury stock, the corporation is not controlled by the provisions of the constitution, statute, or charter regulating the amount of consideration for which stock of an original issue must be sold.¹¹⁶ The corporation may sell treasury stock at whatever price it can procure for it; purchasers do not become liable to corporate creditors for the difference between the par value of the stock and the amount that

¹¹⁴ The power of the directors to issue and sell no par value shares at different prices was sustained in *Bodell v. General Gas & Elec. Co.*, supra (Note 1). It should be remembered that the problem of the power to sell shares of the same issue of stock at different prices is distinct from the question of legality of having stocks of different par value in the capital structure. In *Westlake Park Inv. Co. v. Jordan*, (1926) 198 Cal. 609, 246 P. 807, it was stated that the capital stock structure cannot consist of shares of the same class of stock with different par values.

¹¹⁵ *Vanderlip v. Los Molinos Land Co.*, (1943) 56 Cal. App. (2d) 747, 133 P.(2d) 467; *State v. Stewart Bros. Cotton Co.*, (1939) 193 La. 16, 190 So. 317. See Ballantine, "The Curious Fiction of Treasury Shares," 34 CALIF. L. REV. 622; "Legal Status of Treasury Shares," 85 U. PA. L. REV. 622.

¹¹⁶ See *Borg v. International Silver Co.*, (1925) 11 F.(2d) 147; *Mudd v. Lanier*, (1945) 247 Ala. 363, 24 So. (2d) 550.

they paid for it.¹¹⁷ Similarly, the corporation may give away treasury stock as a bonus to stimulate the sale of original issues of stock.

STOCK PURCHASE WARRANTS

Nature of stock purchase warrants. A stock purchase warrant is an instrument which grants the holder the right to purchase a fixed number¹¹⁸ or shares of stock¹¹⁹ of the corporation at some future time, at a fixed cash price. This instrument may either be attached to the stock or other securities, such as bonds, notes or debentures, or it may be issued independently.¹²⁰

Warrants that are attached to the security may be either detachable or nondetachable. If detachable, the warrant may pass from hand to hand¹²¹ and it may be exercised without presentation of the security to which it was attached on original issue. If nondetachable, the warrant is exercisable only upon presentation of the security to which it is attached. In some cases, a warrant is nondetachable until a fixed date, and detachable after that date.

Distinction between stock purchase warrant and right to subscribe. The term warrant is often loosely employed to indicate either a stock purchase warrant or a right of stockholders to subscribe (preëmptive rights) to additional issues of stock. The distinction between the stock purchase warrant and the right to subscribe to stock, however, should be kept clearly in mind. The stock purchase warrant creates merely a future right to acquire stock of the corporation at a fixed price. This right is generally exercisable by its holder. The issuing corporation is

¹¹⁷ *Mudd v. Lanier*, supra (Note 116); *Furlong v. Johnston*, (1924) 209 App. Div. 198, 204 N.Y. Supp. 710, aff'd, 237 N.Y. 141, 145 N.E. 910. See however, *State v. Stewart Bros. Cotton Co.*, supra (Note 115), involving a statute prohibiting officers from disposing of treasury stock at a price less than they paid for it.

The price may be less than par; *Belle Island Corp. v. McBean*, (1948) 30 Del. Ch. 373, 61 A.(2d) 699, or less than the market price, *Sandler v. Schenley Industries, Inc.*, (1951) 32 Del. Ch. 46, 79 A.(2d) 606.

¹¹⁸ A warrant sometimes calls for the purchase of less than a full share of stock. See page 878.

¹¹⁹ Stock purchasable under a warrant is generally common stock.

¹²⁰ See *Tripp v. North Butte Mining Co.*, (1938) 100 F.(2d) 188.

¹²¹ In *Garner and Forsythe*, "Stock Purchase Warrants and 'Rights'," 5 SO. CALIF. L. REV. 375, it was stated that, although a stock purchase warrant is not a negotiable instrument, some of the qualities of a negotiable instrument may be secured by the insertion of a provision in the warrant making title transferable.

under an obligation to issue stock called for by the warrant. The right to subscribe grants a present privilege to purchase stock proposed to be issued by the corporation.¹²² This right is exercisable by the existent stockholders only. The corporation, however, is under no duty to issue any stock.

Distinction between stock purchase warrant and right of conversion. A stock purchase warrant must also be distinguished from the right of conversion granted with some stock¹²³ and bonds.¹²⁴ A stock or bond is convertible if it gives its holder the right to convert it into, or exchange it for, some other form of security. Thus, a convertible preferred stock may be converted into a common stock; a convertible bond may be exchanged for a common stock. The chief distinction between convertible stock or bond and a stock purchase warrant is the manner in which the conversion privilege is exercised. In the case of conversion, the stock or bond itself is surrendered and some other stock or new stock is received in exchange. In the case of a stock purchase warrant, the warrant is similarly surrendered, but it must be accompanied by a cash payment for the purchase of the stock called for by the warrant.

Purpose of stock purchase warrants. The primary purpose of a corporation in issuing stock purchase warrants is to give to the security that the warrant accompanies a speculative value, and thus to enhance the security's marketability. If the value of the common stock is higher than the price fixed in the warrant during the period in which it is exercisable, the holder is in a position to make a profit, either by selling the warrant separately, if it is detachable, or by exercising his right to purchase the common stock.

Stock purchase warrants have sometimes been used to assure control of the corporation to its existing management.¹²⁵ The managers

¹²² Preemptive rights are discussed in Chapter 21 at p. 913. The relation of preemptive rights to stock purchase warrants is discussed in 4 SO. CALIF. L. REV. 269-292, 375-395.

¹²³ Usually, conversion is at the option of the stockholder and permits the conversion of senior securities into junior securities of the same corporation. Stock cannot be made convertible into bonds except at the option of the corporation.

¹²⁴ A convertible bond is one that gives the security holder the right to exchange his bonds for some other security, usually preferred stock or common stock of the corporation, on a fixed basis described in the indenture. See 36 YALE L.J. 649 on "Convertible Bonds and Stock Purchase Warrants."

¹²⁵ See *Hechler v. Emery*, (1928) 131 N.Y. Misc. 393, 226 N.Y. Supp. 599, 133 N.Y.

are given warrants to purchase stock at a given price, and are thus placed in a position to acquire sufficient stock to retain control at any time that such control is threatened by the joining of forces of other stockholders. The warrants are sometimes issued as a type of "incentive payment" to important executives, as a means of inducing them to accept employment with the corporation.

Protection against losses in short sales is sometimes afforded through the stock purchase warrant. If the price of stock that has been sold short rises, the warrant holder may exercise his warrant at the price fixed and thus obtain the stock to meet the short sale.

Issuance of stock purchase warrants. The power to issue stock purchase warrants is generally vested by statute or charter in the board of directors, and consent of the stockholders is not required unless the charter so provides. The issuance of stock purchase warrants is usually authorized at the same time and in the same manner as is the issuance of the security that the warrant is to accompany. The resolution authorizing the issuance of the securities with the warrants generally empowers the officers of the corporation to execute an indenture, setting forth the form of the warrants and the terms and conditions upon which the warrants are to be issued and exercised. The indenture is in the form of an agreement between the corporation and some bank or trust company as trustee for the warrant holders, and sets forth all the rights and obligations of the warrant holders, the corporation, and the trustee. While it is customary to have a warrant agreement, such an agreement is not necessary. In some instances, the terms and conditions under which the warrants are issued are set forth in the warrant itself.

Protection of rights of warrant holders. The privilege of purchasing common stock at a fixed price may be diluted, changed, or destroyed by various acts of the corporation. For example, the value of the warrant is diminished by the sale of common stock at a price lower than that fixed in the warrant. To protect the holder of a stock purchase warrant against any dilution, change, or destruction of his privilege, the indenture or stock purchase warrant agreement gener-

Misc. 689, 234 N.Y. Supp. 46, for a comparable option contract situation. See also discussion of "Options to purchase stock" at p. 880.

ally contains specific provisions for the adjustment of the terms of the warrant, and for the granting of additional rights in certain contingencies. In the absence of such provisions, the warrant holder is afforded no protection, for his rights are limited by his contract.

The protective clauses in different agreements vary, but generally they include the following:

1. Upon the sale by the corporation of common stock at less than the price fixed in the warrant, the price payable under the warrant is correspondingly decreased, or the number of shares purchasable is adjusted.

2. Upon the grant of options to purchase stock at less than the price at which the stock may be purchased under the warrant, the option is treated as a sale, and a corresponding adjustment is made in the price payable under the warrant.

3. Upon the issuance of securities convertible into common stock at a price less than the price fixed in the warrant, the transaction is treated as a sale of the common stock necessary to effect the conversion, and a corresponding adjustment is made in the price payable under the warrant.

4. Upon the issuance of stock with the right to participate with common stock in dividends and other participations, the corporation is required first to offer to warrant holders the option to purchase a proportionate share of such stock.

5. Upon a split-up or combination of the shares of stock purchasable with the warrant, the number of shares deliverable upon exercise of the warrant shall be replaced by the number of the subdivided or consolidated shares, as the case may be.

6. Upon the payment of a stock dividend on common stock, an adjustment is made in the price payable under the warrant, or the corporation is required to deposit with the trustee common stock, to be distributed to the warrant holders upon the exercise of their rights.

7. Upon the reorganization of the corporation, merger, consolidation, sale of assets, or reclassification of its stock, the corporation is required to deliver to the trustee, for the benefit of warrant holders

upon exercise of their warrants, such securities as holders of the common stock of the corporation are entitled to upon the reorganization, merger, consolidation, sale of assets, or reclassification.

8. Upon the offer of rights to subscribe to stock, the warrant holders are entitled to purchase such stock so offered, to the same extent as though they had then exercised their warrants.

9. Upon the redemption of the stock to which the warrant is attached, the warrant holder may exercise the warrant up to a date later than the date of redemption, or another detached warrant may be issued.

10. In case of a sale of the entire assets of the corporation, or in case of the distribution of the assets in partial or total dissolution or liquidation, the holders of the stock purchase warrants are given an opportunity to exercise their privilege and thus participate in the distribution of the consideration to be received by the corporation upon the sale of its entire assets, or upon the distribution of the assets in partial or total liquidation.

Under the terms of the indenture, the corporation is generally required to give to the trustee and to the warrant holders written notice of any of the above acts contemplated by them, and of the rights of the warrant holders arising therefrom.

Form of warrant. The stock purchase agreement specifies the form in which the warrant is to be issued. Detachable warrants are issued in bearer form; nondetachable warrants are issued to the holder of the certificate of stock or any other security to which the warrant is attached.¹²⁰ The warrant sets forth the number of shares of stock purchasable under the warrant, the price at which such shares are purchasable, and the time within which the warrant must be exercised. It also enumerates, in brief, the terms and conditions under which the warrants are issued, and under which they may be exchanged and exercised, with special reference to the stock purchase agreement in cases where such terms and conditions appear in full. The warrants are dated and numbered, and are authenticated by the

¹²⁰ Warrants have in rare instances been issued as instruments separate and apart from the security which they accompanied. These instruments were made out in the name of designated individuals.

signature of the proper officers of the corporation, exactly as in the case of a certificate of stock. Sometimes temporary typewritten or printed warrants are issued pending the issuance of definitive warrants.

Warrants for purchase of fractional shares. The stock purchase warrant may entitle the holder to purchase a fraction of a share of stock at a certain price. Upon the exercise of such a warrant, the corporation generally issues scrip to represent the fractional shares purchased. This scrip does not entitle the holder thereof to vote, to receive dividends, or to any other right or interest except that of converting the scrip into full shares upon presentation, together with other scrip aggregating one or more full shares, at the office of the trustee. Warrants for fractional shares may be surrendered to the trustee, and, with other warrants for fractions of shares, may be exchanged for warrants for a number of full shares equal to the total of such fractional shares.

Time within which warrants may be exercised. Generally, under the terms of the stock purchase warrant agreement, the warrant may be exercised on or before a fixed date.¹²⁷ In some instances, the warrant may be exercised at a certain price up to a certain date, and at increasingly higher prices at later dates.¹²⁸ The corporation may extend the time within which the warrant may be exercised. In this event, the board of directors, or any other body that originally authorized the execution of the stock purchase warrant agreement, authorizes an amendment of the agreement and of the warrants created thereunder, to reflect the change in date for the exercise of the warrants. Holders of the warrants are, of course, duly notified of the extension of time for the exercise of their warrants.

Manner of exercising the warrant. The holder of a stock purchase warrant desiring to exercise his right to purchase the stock called for under the warrant must present the warrant to the trustee, together with the amount fixed in the warrant as the purchase price

¹²⁷ Sometimes warrants are made exercisable after a certain date, and the corporation is allowed, at its discretion, upon notice to warrant holders, to permit the exercise of the warrant at an earlier date. Warrants may be and have been issued without limitation as to the time within which they may be exercised.

¹²⁸ In other cases, the price at which the warrant may be exercised increases as a certain fixed number of all the rights issued have been exercised.

of the stock. Detachable warrants may be presented without the security to which they were originally attached, and the holder may freely present all or a part of the warrants that he holds. He may also purchase shares of stock less in number than the full number purchasable under the warrant. The warrant is surrendered and cancelled, and a new warrant is issued for the number of shares for which the surrendered warrant was not exercised. Nondetachable warrants, on the other hand, may be exercised only by presentation of the stock certificate with the warrant attached. The holder of a nondetachable warrant, like the holder of a detachable warrant, however, may exercise his right to purchase only a part of the shares called for by the warrant. Upon presentation of his certificate of stock with warrant attached, he may receive in exchange two or more certificates of stock with attached warrants for as many shares of stock as have not been purchased under the original warrant.

Stock to meet exercise of warrants. The corporation must be prepared to meet the exercise of its outstanding warrants by the issuance of stock called for by the warrants. Under the terms of the stock purchase warrant agreement, the corporation irrevocably sets aside the total number of shares that it may be required to issue. As warrants are exercised, the stock so set aside is issued, and the capitalization of the corporation is correspondingly increased. In order to counteract this increase in capitalization, some stock purchase agreements provide that the funds received upon the exercise of the warrants must be used to redeem or purchase outstanding preferred stock. In some instances, a part of the proceeds received from the exercise of the stock purchase warrant is added to the sinking fund that protects the security to which the warrant was attached.

It is a common practice for the corporation to deliver to the trustee one or more stock certificates issued in the name of the company and indorsed in blank by it, representing the total amount of stock that it may be required to issue if all the warrants are exercised. These stock certificates are held by the trustee in trust and are exchangeable for certificates issued in the name of the company and indorsed in blank by it, in such denominations as may be requested by the trustee.

As rights granted by the warrants are exercised, the trustee notifies the corporation in writing, and from the stock certificates indorsed in blank and held in trust by the trustee, the latter makes delivery, as agent for the corporation, of stock certificates representing the shares purchased. The corporation will always furnish the trustee with certificates for any denominations required to meet the demands of those holding the warrants, in lieu of blank certificates held by the trustee. Of course, the trustee can exercise no voting rights with respect to the stock so held "in blank," nor can the board of directors vote it.

Purchase and sale of warrants. Warrants may have a market value, whether they are detachable or nondetachable. If the purchase price fixed in the warrant is lower than the market price of the stock purchasable under the warrant, the warrant is worth at least the difference between the market price and the purchase price. In addition, the warrant has a speculative value based on the possibility of a rise in the market price of the stock called for in the warrant. Warrants that are detachable may be purchased and sold in the open market, irrespective of the security that they originally accompanied. Nondetachable warrants, on the other hand, while they may enhance the value of the security to which they are attached, cannot circulate alone in the market. They may be bought and sold only as part of the security that they accompany.

An "arbitrage" between warrants and stock—that is, the sale or purchase of either in the open market to realize the difference between market price and the stated option price—has been common practice, but it is looked upon with disfavor.

OPTIONS TO PURCHASE STOCK

Nature of options to purchase stock. An option to purchase stock can be distinguished from a stock warrant in that it does not attach to or accompany any other security. An option is a contract, by the terms of which the owner of property, the optionor, agrees that another party, the optionee, shall have the right to buy certain shares of stock belonging to the optionor, at a fixed price and within a

limited period of time.¹²⁹ The price does not have to be stated. It is sufficient if the option contract prescribes a method by which the price can be determined.¹³⁰ An option at a stated price "on terms to be agreed upon" has been upheld.¹³¹ An option must be exercised within the time fixed, or, if no time is fixed, within a reasonable time.¹³² The distinguishing characteristic of an option is that the optionee assumes no obligation,¹³³ but the optionor cannot withdraw from the contract until the time limit expires.¹³⁴ The optionor cannot compel the optionee to proceed even if the latter has made some payment on the option.¹³⁵ In effect, a valid option is an offer to sell,¹³⁶ and a contract to keep the offer open for a specified time.¹³⁷ An option agreement that is not supported by a consideration is merely an offer that can be revoked by the optionor any time before it is accepted by the optionee.¹³⁸ But an option becomes an enforceable con-

¹²⁹ For definitions of options, see *Jones v. Vereen*, (1935) 52 Ga. App. 157, 182 S.E. 627; *Mitzlaff v. Midland Lumber Co.*, (1930) 338 Ill. 575, 170 N.E. 695; *Axe v. Tolbert*, (1914) 179 Mich. 556, 146 N.W. 418; *Anthis v. Sandin*, (1931) 149 Okla. 126, 299 P. 458; *Northside Lumber & Bldg. Co. v. Neal*, (1929) (Tex. Civ. App.) 23 S.W.(2d) 858. For a general discussion of the subject, see James "The Law of Option Contracts," Dom. L.R. (1930) Part 1, pp. 1-26.

¹³⁰ *R. F. Robinson Co. v. Drew*, (1928) 83 N.H. 459, 144 A. 67; *In re Galewitz' Estate*, (1955) 3 N.Y. Misc.(2d) 197, 148 N.Y.S.(2d) 823; *In re Sherman's Will*, (1956) 2 App. Div. (2d) 662, 152 N.Y.S.(2d) 250; *Morrison v. St. Anthony Hotel*, (1955) (Tex. Civ. App.) 274 S.W.(2d) 556. See *Allen v. Biltmore Tissue Corp.*, (1957) 2 N.Y.(2d) 534, 141 N.E.(2d) 812, comment, 31 N.Y.U.L. REV. 1429.

¹³¹ *Morris v. Ballard*, (1926) 16 F.(2d) 175.

¹³² *West Texas Utilities Co. v. Ellis*, (1937) (Tex. Civ. App.) 102 S.W.(2d) 234, rev'd on other grounds, 126 S.W.(2d) 13. But see *Kingston v. Home Life Ins. Co.*, (1917) 11 Del. Ch. 258, 101 A. 898, aff'd, 11 Del. Ch. 428, 104 A. 25.

¹³³ *Suburban Improvement Co. v. Scott Lumber Co.*, (1932) 59 F.(2d) 711, cert. den., 53 S. Ct. 123; *Oleson v. Bergwell*, (1939) 204 Minn. 450, 283 N.W. 770; *McHenry v. Mitchell*, (1908) 219 Pa. 297, 68 A. 729. Whether a particular agreement is an option or a sale depends upon the document and intent of the parties. *Thompson v. Sweet*, (1932) 91 Colo. 552, 17 P.(2d) 308; *Suburban Improvement Co. v. Scott Lumber Co.*, supra.

¹³⁴ *Postel v. Hagist*, (1928) 251 Ill. App. 454; *Moresi v. Burleigh*, (1930) 170 La. 270; 127 So. 624.

¹³⁵ *Bruce v. Mieir*, (1932) 120 Cal. App. 287, 7 P.(2d) 1037.

¹³⁶ *Madison Limestone Co. v. McDonald*, (1956) 264 Ala. 295, 87 So.(2d) 539; *Russ v. Tuttle*, (1910) 158 Cal. 226, 110 P. 813; *Price v. Town of Ruston*, (1932) 19 La. App. 356, 139 So. 55; *Kingston v. Anderson*, (1940) 3 Wash.(2d) 21, 99 P.(2d) 630.

¹³⁷ *Behrman v. Max*, (1931) 102 Fla. 1094, 137 So. 120; *Bayfield v. Defenbacher*, (1932) 266 Ill. App. 385; *First Nat'l Bank v. Corporation Securities Co.*, (1915) 128 Minn. 341, 150 N.W. 1084; *Spitzli v. Guth*, (1920) 112 N.Y. Misc. 630, 183 N.Y. Supp. 743.

¹³⁸ *Thomas v. Birch*, (1918) 178 Cal. 483, 173 P. 1102; *Ankeney v. Brenton*, (1931) 214 Iowa 357, 238 N.W. 71; *Gillen v. Bayfield*, (1931) 329 Mo. 681, 46 S.W.(2d) 571; *Brinley v. Nevins*, (1914) 162 App. Div. 744, 147 N.Y. Supp. 985.

tract, if it is supported by a consideration,¹³⁹ or if the optionee has accepted the offer within the time specified.¹⁴⁰

The same legal principles of contract law that govern options to purchase other property are also applicable to options to purchase stock.¹⁴¹ The supporting cases in the footnotes are therefore not limited to those involving options to purchase stock.

Employee stock option. A corporation may grant its employees an option to purchase its stock by individual agreement¹⁴² or under a general plan.¹⁴³ A valid option agreement or option plan, as it is also called, must conform to the general legal principles governing option contracts¹⁴⁴ as well as to the general rules governing the conduct of corporate affairs.¹⁴⁵ Unless statutes or charter provide otherwise, an option agreement or option plan should protect any preëemptive rights of the existing shareholders.¹⁴⁶ The usual purpose of an option agreement is to obtain the services of the employees either individually or as a group for the corporation,¹⁴⁷ or to give them additional compensation with more favorable tax treatment.¹⁴⁸ A promise to as-

¹³⁹ *Baker v. Mulrooney*, (1920) 265 F. 529; *Copple v. Aigeltinger*, (1914) 167 Cal. 706, 140 P. 1073; *Prior v. Hilton & Dodge Lumber Co.*, (1913) 141 Ga. 117, 80 S.E. 559; *Leadbetter v. Price*, (1921) 103 Ore. 222, 202 P. 104; *Baker v. Shaw*, (1912) 68 Wash. 99, 122 P. 611.

¹⁴⁰ *Ankeney v. Brenton*, supra (Note 138); *Gillen v. Bayfield*, supra (Note 138); *Moresi v. Burleigh*, supra (Note 134).

¹⁴¹ *Frissell v. Nichols*, (1927) 94 Fla. 403, 114 So. 431; *Jones v. Vereen*, supra (Note 129); *Monahan v. Allen*, (1913) 47 Mont. 75, 130 P. 768.

¹⁴² *Wyles v. Campbell*, (1948) 77 F. Supp. 343; *McQuillen v. National Cash Register Co.*, (1939) 27 F. Supp. 639; *Sandler v. Schenley Industries, Inc.*, (1951) 32 Del. Ch. 46, 70 A.(2d) 606; *Milwaukee Sanitarium v. Swift*, (1941) 238 Wis. 628, 300 N.W. 760.

¹⁴³ *Clamitz v. Thatcher Mfg. Co.*, (1947) 158 F.(2d) 687; *Kaufman v. Schoenberg*, (1952) 33 Del. Ch. 211, 91 A.(2d) 768; *Eliasberg v. Standard Oil Co.*, (1952) 23 N.J. Super. 431, 92 A.(2d) 862. See also *Holthusen v. Edward G. Budd Mfg. Co.*, (1943) 52 F. Supp. 125, 53 F. Supp. 488.

¹⁴⁴ *Gottlieb v. Heyden Chemical Corp.*, (1951) 32 Del. Ch. 231, 83 A.(2d) 595, rev'd on other grounds, 33 Del. Ch. 82, 90 A.(2d) 660.

¹⁴⁵ *Steinberg v. Sharpe*, (1950) 95 F. Supp. 32, aff'd, 190 F.(2d) 282; *Wyles v. Campbell*, supra (Note 142); *Clamitz v. Thatcher Mfg. Co.*, supra (Note 143); *Abrams v. Allen*, (1942) 36 N.Y.S.(2d) 174, aff'd, (1943) 266 App. Div. 835, 42 N.Y.S.(2d) 641. See also *Greene v. Dietz*, (1956) 143 F. Supp. 464.

¹⁴⁶ *Gottlieb v. Heyden Chemical Corp.*, supra (Note 144); *Elward v. Peabody Coal Co.*, (1956) 9 Ill. App. 234, 132 N.E.(2d) 549; *Eliasberg v. Standard Oil Co.*, supra (Note 143); *Milwaukee Sanitarium v. Swift*, supra (Note 142).

¹⁴⁷ *Spirit v. Bechtel*, (1956) 232 F.(2d) 241; *Clamitz v. Thatcher Mfg. Co.*, supra (Note 143); *Kerbs v. California Eastern Airways, Inc.*, (1952) 33 Del. Ch. 82, 90 A.(2d) 652.

¹⁴⁸ *Eliasberg v. Standard Oil Co.*, supra (Note 143). See also Sec. 421, I.R.C. of 1954.

sume an executive position,¹⁴⁹ continuation of employment after a proposed resignation,¹⁵⁰ and continuation of employment with disposal of outside interests,¹⁵¹ have been held to be good consideration for the grant of a stock option. It has been held that the corporation, in granting a stock option to its employees, must be assured that the services will be continued for period of time, usually a year or more.¹⁵² The value of the services should also bear a reasonable relation to the value of the option at the time it is granted.¹⁵³ Usually the judgment of the board of directors, exercised in good faith, as to the value of the services or benefits received by the corporation for stock options is conclusive.¹⁵⁴

State statutes governing stock option plans generally require approval by the stockholders. Employee option plans have been attacked by dissenting stockholders as wasteful, fraudulent, and violative of preëemptive rights.¹⁵⁵ In states where stockholder approval is not required by law, it is nevertheless advisable to submit the plans for stockholders' approval.¹⁵⁶ This precaution is important when directors or officers receive benefits from the plan.¹⁵⁷ If the plan has been approved by a majority of stockholders, the dissenting stockholders must establish that the directors did not act in good faith.

¹⁴⁹ *McQuillen v. National Cash Register Co.*, supra (Note 142).

¹⁵⁰ *Wyles v. Campbell*, supra (Note 142).

¹⁵¹ *Sandler v. Schenley Industries, Inc.*, supra (Note 142).

¹⁵² *Holthausen v. Edward G. Budd Mfg. Co.*, supra (Note 143); *Kerbs v. California Eastern Airways, Inc.*, supra (Note 147); *Eliasberg v. Standard Oil Co.*, supra (Note 143). But see *Clamitz v. Thatcher Mfg. Co.*, supra (Note 143). Where options could be exercised at once, plans were held invalid in *Frankel v. Donovan*, (1956) (Del. Ch.) 120 A. (2d) 311; *Kerbs v. California Eastern Airways, Inc.* supra (Note 147); *Rosenthal v. Burry Biscuit Corp.*, (1948) 30 Del. Ch. 299, 60 A.(2d) 106.

In *McPhail v. L. S. Starrett Co.*, (1957) 157 F. Supp. 560, it was said that an option given almost all employees, which had to be exercised within 30 days, and at the market price, had no market value and, therefore, required no consideration.

¹⁵³ *Clamitz v. Thatcher Mfg. Co.*, supra (Note 143); *Frankel v. Donovan*, supra (Note 152); *Kerbs v. California Eastern Airways, Inc.*, supra (Note 147); *Abrams v. Allen*, supra (Note 145).

¹⁵⁴ Some states expressly so provide by statute. See also *Clamitz v. Thatcher Mfg. Co.*, supra (Note 143); *Frankel v. Donovan*, supra (Note 152); *Kerbs v. California Eastern Airways, Inc.*, supra (Note 147). See also "Employee Stock Option Plans—the Clydesdale Rule," 52 COLUM. L. REV. 1003.

¹⁵⁵ See note, "Legality of Stock Option Grants to Officers," 49 COLUM. L. REV. 232. See also *Krantman v. Liberty Loan Corp.*, (1957) 246 F.(2d) 581.

¹⁵⁶ *Spirit v. Bechtel*, supra (Note 147).

¹⁵⁷ *Kaufman v. Schoenberg*, supra (Note 143). See also 52 COLUM. L. REV. 1003.

Without shareholder approval, the directors are on the defensive to prove good faith.¹⁵⁸ A majority of stockholders is without power to validate a stock option plan that is without consideration.¹⁵⁹ Unanimous action of all stockholders cannot validate an illegal stock option plan.¹⁶⁰

¹⁵⁸ *Gottlieb v. Heyden Chemical Corp.*, *supra* (Note 144); *Eliasberg v. Standard Oil Co.*, *supra* (Note 143). See also 53 COLUM. L. REV. 283.

¹⁵⁹ *Frankel v. Donovan*, *supra* (Note 152).

¹⁶⁰ *Elward v. Peabody Coal Co.*, *supra* (Note 146).

CHAPTER 20

CALLS AND ASSESSMENTS

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Calls and Assessments

Meaning of a call. A call for payment of an unpaid subscription is an official declaration that the sum subscribed, or any specified installment or amount, is required to be paid.¹ The term "call" is applied to the resolution calling for payment, to the notice or demand for payment, and sometimes to the time when payment is due. The words "call" and "assessment" are frequently used interchangeably, for assessment also means that a fixed payment is required of the stockholders. Call, however, is generally understood to apply to unpaid subscriptions, whereas assessment is used to designate additional payments required to be made on stock that is already fully paid.²

Necessity for calls for payment. The time when payment must be made for stock is generally determined by the provisions of the contract between the corporation and the purchaser of the stock.³ Usually the subscription contract, or contract of purchase, fixes the time of payment, or indicates that payment shall be made in such installments as shall from time to time be called by the directors. In the absence of any indication in the agreement as to when payments are due, it is understood that they are due on call,⁴ and payment is not due from a subscriber until a call has been issued. In other words, a call for payment must be made before the corporation can bring an action against the subscriber for the amount due.⁵ A subscriber, how-

¹ *Campbell v. American Alkali Co.*, (1903) 125 F. 207; *Wall v. Basin Mining Co.*, (1909) 16 Idaho 313, 101 P. 733; *Germania Iron Mining Co. v. King*, (1896) 94 Wis. 439, 69 N.W. 181.

² *Seyberth v. American Commander Mining & Milling Co.*, (1926) 42 Idaho 254, 245 P. 932.

³ It has been held that a subscriber may agree with a third person to pay his subscription at certain times and in certain amounts, subject to statute or charter limitations. *Wark Co. v. Beach Hotel Corp.* (1931) 113 Conn. 119, 154 A. 252.

⁴ *San Bernadino County Sav. Bank v. Denman*, (1921) 186 Cal. 710, 200 P. 606.

⁵ *Glenn v. Marbury*, (1892) 145 U.S. 499, 12 S. Ct. 914; *Coast Amusements v. Stineman*, (1931) 115 Cal. App. 746, 2 P.(2d) 447; *Handley Inv. Co. v. Trenholme*, (1916) 91 Wash. 146, 157 P. 472.

ever, may waive the necessity for a call and pay for his stock in full or in part at any time.⁶ Some courts have held that the subscriber may pay in full for his stock before payment is due only if the corporation is willing to accept payment.⁷ If the subscription contract indicates when specific payments must be made, the subscriber must pay the installments as they fall due; it is not necessary for the corporation to call for payment.⁸ If an agreement is silent as to the time of payment, the subscription is due and payable at once.⁹ However, the statutory provisions governing calls may be deemed part of the contract to be complied with before the corporation can sue for the unpaid amount.¹⁰ When the subscriber repudiates the subscription, no call is necessary to make him liable.¹¹

Authority to make calls. A call, in order to be valid, must be made by proper authority in compliance with any express provisions contained in the statute, charter, by-laws, or subscription contract.¹² The statute, charter, and by-laws usually confer the power of making calls for unpaid subscriptions upon the directors. If the statute does not expressly impose upon the directors the duty of making calls, the power to issue calls may be given to the stockholders. However, the board of directors must make the calls for payment in the absence of a provision conferring the power on others.¹³ If the call is made without proper authority, it is invalid unless it has been ratified by those who originally had the authority.

⁶ *San Bernadino County Sav. Bank v. Denman*, *supra* (Note 4). See also *Wark v. Beach Hotel Corp.*, (1931) 113 Conn. 119, 154 A. 252.

⁷ *Welch v. Sargent*, (1899) 127 Cal. 72, 59 P. 319; *Wark v. Beach Hotel Corp.*, *supra* (Note 6).

⁸ *Myrtle Point Mill & Lumber Co. v. Clarke*, (1922) 102 Ore. 533, 203 P. 588; *Commonwealth Bonding & Cas. Ins. Co. v. Hill*, (1916) (Tex. Civ. App.) 184 S.W. 247; *Columbus Institute v. Conohan*, (1916) 164 Wis. 219, 159 N.W. 720.

⁹ *Harris v. Gateway Land Co.*, (1900) 100 Ala. 652, 29 So. 611.

¹⁰ *Vegetable Oil Corp. v. Twohy*, (1927) 86 Cal. App. 409, 260 P. 813.

¹¹ *Shiffer v. Akenbrook*, (1921) 75 Ind. App. 149, 130 N.E. 241.

¹² *Grafton v. Masteller*, (1956) 232 F.(2d) 733; *Wood v. Universal Adding Mach. Co.*, (1911) 166 Ill. App. 346; *Germania Iron Mining Co. v. King*, *supra* (Note 1).

¹³ See *Budd v. Multnomah St. Ry.*, (1887) 15 Ore. 413, 15 P. 659.

A valid call may be made by persons succeeding to the powers of the board of directors, such as a receiver for the benefit of creditors. In *re Phoenix Hardware Co.*, (1918) 249 F. 410; *Carpenter v. Griffith Mortgage Corp.*, (1934) 20 Del. Ch. 132, 172 A. 447. *State ex rel. Havner v. Associated Packing Co.*, (1929) 210 Iowa 754, 227 N.W. 627.

In the *Carpenter* case the court denied a request for a general call to equalize the losses among the shareholders.

Where the power to make calls is vested in the board of directors, a call must be made by a properly constituted board at a regular meeting, or at a special meeting properly called.¹⁴ However, if all the directors are personally present and participate in making the call, the fact that notice of the meeting has not been given as provided in the by-laws is immaterial.¹⁵ The board, or whoever has authority to make calls, has the right to determine whether a call is advisable; the action of directors who have authority to make a call cannot be questioned by the stockholders, if the call has been made in good faith and for corporate purposes.¹⁶ The directors, of course, would have no power to make calls at times and for purposes in violation of the agreement entered into with subscribers.¹⁷ If the subscription contracts contain an express or implied condition that all the capital stock must be subscribed for before calls can be made, calls made while this condition remains unfulfilled are invalid, unless performance of the condition has been waived, or unless the stockholders are estopped from insisting upon its performance.¹⁸

Determination of amount of call. The same authority that has the power to make calls for the payment of capital stock has the power to determine the amount for which calls will be made, subject to the express or implied limitations of the statute, charter, by-laws, or subscription contract.

To be valid, calls must be uniform and in ratable amounts. Calls requiring some stockholders to pay a higher rate than others are unjust and void.¹⁹ But this rule of equality is not violated by calls against the subscriptions of certain stockholders for the purpose of producing a sum sufficient to make the payments of these stockholders equal to payments already made by other stockholders.²⁰

¹⁴ *Cheney v. Canfield*, (1910) 158 Cal. 342, 111 P. 92.

¹⁵ *Minneapolis Times Co. v. Nimocks*, (1893) 53 Minn. 381, 55 N.W. 546.

¹⁶ *Nashua Sav. Bank v. Anglo-American Land, Mortgage & Agency Co.*, (1903) 189 U.S. 221, 23 S. Ct. 517; *Budd v. Multnomah St. Ry.*, *supra* (Note 13).

¹⁷ *Grafton v. Masteller*, *supra* (Note 12). See also *Farmers' Lumber Co. v. Luikart* (1927) 36 Wyo. 413, 256 P. 84.

¹⁸ *Huxtable v. Shumate*, (1922) 79 Ind. App. 293, 134 N.E. 896.

¹⁹ *Geary St., P. & O. R.R. v. Rolph*, (1922) 189 Cal. 59, 207 P. 539; *Great Western Tel. Co. v. Burnham*, (1891) 79 Wis. 47, 47 N.W. 373. See also *Germania Iron Mining Co. v. King*, *supra* (Note 1).

²⁰ *Imperial Land & Stock Co. v. Oster*, (1917) 34 Cal. App. 776, 168 P. 1159.

Resolution authorizing call for payment. The law requires that the terms of a call shall be definite,²¹ and that there shall be some act showing clearly an official intent to render due and payable all or a part of the unpaid subscription.²² To comply with these requirements, it is customary for a board of directors having the power to make calls, to adopt a resolution, at a regular meeting or at a special meeting properly called, containing the following information:

1. The stockholders to whom the call applies.²³
2. The amount or percentage of the subscription required to be paid.
3. The time when payment is due.
4. The place where payment is to be made.
5. The person to whom payment is to be made.
6. Directions for the giving of notice of the call by the proper corporate officer.

From a legal standpoint, all of this information may not be necessary.²⁴ It has been held that a call is valid even if the resolution does not name the place at which or the person to whom payment is to be made, provided that the notice of the call gives this information.²⁵ It is a good practice, however, to include all the information listed above in the resolution. The resolution should be carefully framed, since the call makes absolute the contingent liability of the stockholder to pay for his stock, and lays the foundation for recovery of payment if the stockholder does not respond to the call.

Notice of calls. According to the weight of authority, notice of calls for payment on stock must be given to stockholders.²⁶ There are cases, however, that hold that no notice is necessary unless expressly or impliedly required by the statute, charter, or by-laws of the corpo-

²¹ *North Milwaukee Town Site Co. No. 2 v. Bishop*, (1899) 103 Wis. 492, 79 N.W. 785.

²² *Budd v. Multnomah St. Ry.*, *supra* (Note 13).

²³ The corporation can look only to the list of stockholders on its books to determine who is liable to call. *Prudential Petroleum Co. v. Peck*, (1933) 132 Cal. App. 4, 22 P.(2d) 559. See also *United States v. Cole*, (1950) 90 F. Supp. 147.

²⁴ *San Bernadino County Sav. Bank v. Denman*, *supra* (Note 4).

²⁵ *American Pastoral Co. v. Gurney*, (1894) 61 F. 41.

²⁶ See *Germania Iron Mining Co. v. King*, *supra* (Note 1).

ration, or by the contract with the stockholder.²⁷ Notice of call, of course, may be waived by the stockholders.

No special form of notice is required, unless the statute, charter, by-laws, or contract prescribe one. The form of notice used should contain all the information required by the statute, charter, by-laws, or contract, and should clearly indicate to the stockholder that a call has been made and that payment is required. It is a good plan to have the notice contain the same information appearing in the resolution authorizing the call.

If no specific length of time is prescribed by statute, charter, by-law, or contract, reasonable notice prior to the issuance of the call is sufficient.²⁸

Irregularities in calls. All statutory, charter, by-law, and contract provisions concerning the necessity for calls, formalities of making calls, and the giving of notice thereof, should be followed. It is true that the courts have at times overlooked irregularities and informalities in calls if there has been a substantial compliance with the statutory requirements and the call has otherwise been adequate;²⁹ but a corporation that would avoid legal entanglements should scrupulously adhere to all requirements. A subscriber, by his acts or by express agreement, may waive informalities in making the call, in the notice of the call, or even in the call itself.³⁰

Remedies of corporation upon failure of subscriber to respond to call for payment. The statutes in most states indicate the remedies available to a corporation upon failure of a subscriber to respond to the call for payment. The various remedies provided may be listed as follows:

1. The corporation may bring an action at law against the delinquent subscriber to recover the amount that still remains unpaid after the call.

²⁷ Ibid.

²⁸ *Fairchild County Turnpike Co. v. Thorp*, (1839) 13 Conn. 173.

²⁹ *Macon & A. R.R. v. Vason*, (1876) 57 Ga. 314.

³⁰ *Graebner v. Post*, (1903) 119 Wis. 392, 96 N.W. 783. See also *Gowans v. Rockport Irrigation Co.*, (1930) 77 Utah 198, 293 P. 4.

2. The corporation may sell at public auction such part of the shares as will pay the call due, plus expenses.

3. The corporation may sell the shares, apply the proceeds to the payment of the installment called for, plus expenses, and refund the excess to the original owner.

4. If the proceeds of a sale are insufficient to pay the installment due, plus expenses, the corporation may sue the delinquent stockholder for the balance.

5. The corporation may declare the stock and all previous payments made thereon to be forfeited to the corporation.

6. The corporation may be given the right to purchase the shares through its secretary, its president, or any director, for the amount of the assessment, plus costs, if no bidder offers the amount of the assessment and costs.

In some states, the statutes permit the corporation to provide, in the by-laws, for the manner of selling shares or forfeiting them for failure to pay calls. Remedies for nonpayment of calls may also be provided by the corporate charter³¹ or by the subscription contract.

Statutory, charter, or contract remedies are generally held to be cumulative and not to abrogate appropriate common law remedies.³² Thus a corporation has the right to sue for the amount of the call, even if, by statute, charter, or contract, it may also have the right to sell or forfeit the shares.³³ However, unless the right to do so is given by the statute,³⁴ the corporation cannot sue at law for the amount of the call after it has used the remedy of forfeiture.³⁵

Forfeiture of shares for nonpayment. The right to forfeit or to sell shares of a subscriber for nonpayment is not an inherent power of the corporation, and therefore, before a corporation is permitted to

³¹ *Bessette v. St. Albans Co-operative Creamery*, (1935) 107 Vt. 103, 176 A. 307.

³² *Campbell v. American Alkali Co.*, *supra* (Note 1); *State v. Associated Packing Co.*, (1929) (Iowa) 227 N.W. 627; *Ohio Valley Industrial Corp. v. H. L. Seabright Co.*, (1931) 111 W. Va. 55, 160 S.E. 300.

³³ *Nashua Sav. Bank v. Anglo-American Land, Mortgage & Agency Co.*, *supra* (Note 16); *Imperial Land & Stock Co. v. Oster*, *supra* (Note 20).

³⁴ *Mandel v. Swan Land & Cattle Co.*, (1895) 154 Ill. 177, 40 N.E. 462. See also *Denman v. Country Club Realty Co.*, (1920) 143 Ark. 502, 220 S.W. 824.

³⁵ *Denman v. Country Club Realty Co.*, *supra* (Note 34); *Quintet Oil Co. v. Big Five Oil Co.*, (1922) 71 Colo. 232, 205 P. 949.

exercise this right, it must have the power delegated to it by the statute or charter. Without such power, a majority of the stockholders cannot pass a by-law permitting the corporation to forfeit shares³⁶ which will bind stockholders who do not assent to the by-law.³⁷ A subscriber may, however, make a contract providing that default in any payment shall operate as a forfeiture of previous payments, unless there is a statute, charter, or by-law provision prohibiting such a contract.³⁸

Forfeitures are not favored by the law, and the provisions of the statute, charter, by-laws, or contract governing forfeitures are strictly construed.³⁹ Those seeking to enforce a forfeiture must observe with exactness all requirements necessary to enable them to exercise this strong power.⁴⁰

If there are no provisions regarding the details to be followed in enforcing a forfeiture of stock, the only requirement is that the method adopted be reasonable and just.⁴¹ The statutes generally indicate the notice that must be given to delinquent subscribers before the corporation can forfeit the shares or apply the remedies permitted by statute. The statutory provision as to notice must be strictly followed.⁴² But an irregularity may be waived by the stockholder and the corporation to validate a forfeiture.⁴³

Any action concerning the forfeiture of stock should be taken by a properly constituted board of directors, at a meeting called as re-

³⁶ See *Monroe Dairy Ass'n v. Webb*, (1899) 40 App. Div. 49, 57 N.Y. Supp. 572. Cf. *Hill v. Partridge Cooperative Equity Exchange*, (1950) 168 Kan. 506, 214 P.(2d) 316.

³⁷ The power to declare forfeiture of corporate stock for nonpayment of the amount due must be exercised in strict compliance with charter or statutory requirements. *Jensen v. Northwestern Underwriters' Ass'n*, (1916) 35 N.D. 223, 159 N.W. 611.

³⁸ *Denman v. Country Club Realty Co.*, supra (Note 34). From *Budd v. Multnomah St. Ry.*, supra (Note 13), it would seem that a by-law with forfeiture provisions could be adopted by unanimous vote of the shareholders if not expressly prohibited by statute or charter.

³⁹ *Matter of N. Y. & Westchester Town Site Co.*, (1911) 145 App. Div. 623, 130 N.Y. Supp. 414.

⁴⁰ *American Well & Prospecting Co. v. Blakemore*, (1920) 184 Cal. 343, 193 P. 779; *Jent v. Friggeri*, (1935) 141 Kan. 144, 40 P.(2d) 343; *Jensen v. Northwestern Underwriters' Ass'n*, (1916) 35 N.D. 223, 159 N.W. 611.

⁴¹ *Crissey v. Cook*, (1903) 67 Kan. 20, 72 P. 541.

⁴² *San Bernadino County Sav. Bank v. Denman*, supra (Note 4); *American Well & Prospecting Co. v. Blakemore*, supra (Note 40).

⁴³ *American Well & Prospecting Co. v. Blakemore*, supra (Note 40); *Crissey v. Cook*, supra (Note 41).

quired by the statute, charter, or by-laws. The record of the meeting, as well as the notice of forfeiture to be sent to subscribers, should be checked against the requirements to insure that the procedure prescribed has been correctly followed.⁴⁴

After forfeiture or sale of shares, the delinquent stockholder is divested of title to the stock. His liability for further payments to the corporation ceases. He is also relieved from liability to creditors for the amount unpaid, even if the debt was contracted with the creditor before the forfeiture.⁴⁵ If the stockholder has been intentionally discharged from liability in order to defraud creditors, the forfeiture is of no effect and the stockholder is not relieved from liability.⁴⁶

§ **Meaning of "assessment."** As indicated in the definition of calls (see page 886), the words "call" and "assessment" are frequently used interchangeably. Strictly speaking, however, the word "assessment" means a demand upon stockholders for payment above the par value of the stock, or in the case of no-par value shares, above the contract price.

Power of corporation to assess fully paid stock. A corporation, in the sale and issuance of its stock, assumes a contractual relation with the shareholder.⁴⁷ One of the carefully guarded rights of the stockholder under the contract is that no demand for payment shall be made by the corporation above the par value or price contracted to be paid for the shares of stock.⁴⁸ In some states, the statutes specifically provide that stock for which the agreed consideration has been paid shall be nonassessable. In others, the assessment is indirectly prohibited; that is, the corporation is given the power to make assessments upon stock, not exceeding in the aggregate the balance remaining unpaid under the contract of subscription.⁴⁹ Stockholders who have paid in full for their shares may not be called upon

⁴⁴ It is not essential that the resolution show that stock of a particular subscriber is being forfeited, if proper notice is given to the subscriber. *Crissey v. Cook*, *supra* (Note 41).

⁴⁵ *Mills v. Stewart*, (1862) 62 Barb. (N.Y. 444, *aff'd*, 41 N.Y. 384; *American Well & Prospecting Co. v. Blakemore*, *supra* (Note 40).

⁴⁶ *American Well & Prospecting Co. v. Blakemore*, *supra* (Note 40).

⁴⁷ *Peters v. United States Mortgage Co.*, (1921) 13 Del. Ch. 11, 114 A. 598.

⁴⁸ *Hill v. Partridge Cooperative Equity Exchange*, *supra* (Note 36).

⁴⁹ See *Moore v. Los Lugos Gold Mines*, (1933) 172 Wash. 570, 21 P.(2d) 253, for a constitutional prohibition of assessment.

to pay an additional assessment unless the statute or the corporate charter authorizes an assessment upon fully paid stock,⁵⁰ or unless an express and valid agreement for the assessment is made with the stockholder.⁵¹ In some states a corporation may amend its charter to provide for the power of assessment.⁵² In other states the corporation is not so privileged.⁵³

Power to assess stock marked "nonassessable." Many corporations issue stock that bears upon its face the words "fully paid and nonassessable." Such a provision becomes a part of the contract between the corporation and the stockholder, and, as between these two parties, the agreement may be relied upon and enforced.⁵⁴ But where the necessity arises to marshal the assets of the corporation for the purpose of discharging its liabilities, the stockholders are obliged to pay whatever amount remains unpaid on their stock, despite the fact that the stock is marked "nonassessable."⁵⁵

In some states, the statute gives the corporation the power to levy an assessment against capital stock that is fully paid up, for the purpose of paying expenses, conducting the business, or paying debts. The fact that the certificates bear upon their face the words "fully paid and nonassessable" renders the shares represented by the certificates nonassessable even under such a statute.⁵⁶ An agreement between the stockholder and the corporation that the stock shall be nonassessable may be evidenced by the certificate of incorporation describing the stock to be issued, or by a provision in the by-laws, the certificates of stock, the subscription contract, or the contract of sale. However, if a statute prohibits a distinction or preference between

⁵⁰ *Schueth v. Farmers' Union Milling & Grain Co.*, (1927) 116 Neb. 14, 215 N.W. 458; *Forsyth v. Selma Mines Co.*, (1921) 58 Utah 142, 197 P. 586; *Huxtable v. Berg*, (1917) 98 Wash. 616, 168 P. 187.

⁵¹ *Milton v. Bergstrom*, (1916) 71 Fla. 197, 70 So. 1008; *Big Creek Ditch Co. v. Hulick*, (1929) 130 Ore. 408, 280 P. 492; *Child v. Idaho Hewer Mines*, (1930) 155 Wash. 280, 284 P. 80. For a review of cases, see 39 *YALE L.J.* 580.

⁵² *Wilson v. Cherokee Drift Mining Co.*, (1939) 14 Cal. 56, 92 P.(2d) 802.

⁵³ *Harris v. Northern Blue Grass Land Co.*, (1911) 185 F. 192; *State ex rel. Brooks v. Overland Beverage Co.*, (1949) 69 Idaho 126, 203 P.(2d) 1009; *Hill v. Partridge Cooperative Equity Exchange*, *supra* (Note 36).

⁵⁴ *A. C. Frost & Co. v. Coeur D'Alene Mines Corp.*, (1939) 60 Idaho 491, 92 P.(2d) 1057; *Whicher v. Delaware Mines Corp.* (1932) 52 Idaho 304, 15 P.(2d) 610.

⁵⁵ *Norton v. Lamb*, (1936) 144 Kan. 665, 62 P.(2d) 1311; *Strong v. Frerichs*, (1938) (Mo. App.) 116 S.W.(2d) 533.

⁵⁶ *Wall v. Basin Mining Co.*, (1909) 16 Idaho 313, 101 P. 733.

shares, such preference or distinction should be stated in the articles of incorporation; otherwise, an agreement between a corporation and one of its stockholders that the shares held by such stockholder shall be nonassessable, is void if the same freedom from liability to assessment is not accorded to all the stockholders.⁵⁷

Assessments under statutory or charter provisions. The statutes permitting the assessment of fully paid stock vary in the several states. Assessments made under these statutes must conform to the requirements of the law,⁵⁸ for the courts strictly construe the provisions of the statutes. Thus, the assessment must be made for the purpose described in the statute.⁵⁹ If the assessment is for a proper purpose, the directors' motive in levying it is immaterial.⁶⁰ If the statute fixes the maximum that may be called for, the assessment should be within the limit prescribed.⁶¹

The assessment, in order to be valid, must be authorized by those given the power by the statute or the certificate of incorporation to levy assessments and must be made in the manner prescribed.⁶² If the directors are authorized to levy an assessment,⁶³ they must do so at a legal meeting, properly called.⁶⁴ As in the case of calls for unpaid subscriptions, an assessment on fully paid stock must be uniform; an assessment upon certain shareholders and not upon others is invalid.⁶⁵ The directors or stockholders, whichever body is authorized to levy the assessment, should do so by resolution, properly proposed, seconded, and voted upon. A complete record should be kept of the action taken. If the certificate of incorporation authorizes the levying of an assessment only upon the vote of a certain percentage of the

⁵⁷ *Martin v. Palmer Union Oil Co.*, (1920) 184 Cal. 386, 193 P. 950.

⁵⁸ *Schroeter v. Bartlett Syndicate Bldg. Corp.*, (1936) 8 Cal.(2d) 12, 63 P.(2d) 824; *Rancho La Sierra v. Bixby*, (1936) 12 Cal. App.(2d) 342, 55 P.(2d) 527.

⁵⁹ *Koshaba v. Koshaba*, (1942) 56 Cal. App.(2d) 302, 132 P.(2d) 854; *Kehlor v. Chesley Finance Corp.*, (1932) 123 Cal. App. 4, 10 P.(2d) 801.

⁶⁰ *Clark v. Oceano Beach Resort Co.*, (1930) 106 Cal. App. 574, 289 P. 946.

⁶¹ *Sanderson v. Salmon River Canal Co.*, (1927) 45 Idaho 244, 263 P. 32.

⁶² An improperly levied assessment may be declared void by the courts. *Koshaba v. Koshaba*, *supra* (Note 59).

⁶³ See *La Plante v. Hopper*, (1932) 127 Cal. App. 146, 15 P.(2d) 525.

⁶⁴ *Boswell v. Mount Jupiter Mut. Water Co.*, (1950) 97 Cal. App.(2d) 437, 217 P.(2d) 980. See also *Farbstein v. Pacific Oil Tool Co.*, (1932) 127 Cal. App. 157, 15 P.(2d) 766, for a valid assessment by de facto directors.

⁶⁵ *Seyberth v. American Commander Mining & Milling Co.*, *supra* (Note 2); *Omaha Law Library Ass'n v. Connell*, (1898) 55 Neb. 396, 75 N.W. 837.

stockholders, the record should show that the required number of stockholders voted in favor of the assessment. An assessment on fully paid shares has been held unenforceable where a proper record of the transaction was not made.⁶⁶ Notice of the assessment should be given to stockholders in strict conformity with the requirements of the statute or the charter.⁶⁷

Enforcement of assessments. The principles concerning the enforcement of assessments on fully paid stock are similar to those applying to the enforcement of calls on unpaid subscriptions (see page 890). Stockholders become liable for the payment of valid assessments, and the corporation may bring an action against them to enforce the liability.⁶⁸ The corporation has no right to forfeit or to sell the shares of stockholders who have failed to pay a valid assessment, unless the statute or charter expressly so provides.⁶⁹ If forfeiture and sales are permitted by the statute or charter, the provisions as to notice of the forfeiture or sale and the requirements as to the manner of conducting the sale must be followed in exact conformity with the law.⁷⁰

Assessments pursuant to agreements with stockholders. Even in the absence of a statutory or charter provision authorizing assessments upon fully paid stock, the stockholders may agree to pay an assessment on fully paid stock for the benefit of the corporation. If the voluntary assessment is supported by a valid consideration, the corporation can enforce the agreement of the assenting stockholders.⁷¹ When stockholders voluntarily pay an assessment, although the stock is fully paid and nonassessable, they cannot later recover payment from the corporation or its officers.⁷²

⁶⁶ *Corcoran v. Sonora Mining & Milling Co.*, (1902) 8 Idaho 651, 71 P. 127.

⁶⁷ *Brown v. St. Paul Consolidated Oil Co.*, (1929) 101 Cal. App. 263, 281 P. 646; *Stivers v. Sidney Mining Co.*, (1949) 69 Idaho 403, 208 P.(2d) 795.

⁶⁸ The person in whose name the stock is registered is liable for assessments even if he holds the stock in trust for another. *Berkeley Hillside Properties Co. v. Kelly*, (1926) 78 Cal. App. 29, 247 P. 600; *Webster v. Bartlett Estate Co.*, (1917) 35 Cal. App. 283, 169 P. 702. Transferees are liable for assessments made after the transfer. *Libby v. Tobey*, (1890) 82 Me. 397, 19 A. 904.

⁶⁹ *Williams v. Lowe*, (1876) 4 Neb. 382.

⁷⁰ *Clark v. Oceano Beach Resort Co.*, *supra* (Note 60); *Newhall v. Hunsaker*, (1918) 38 Cal. App. 399, 176 P. 380; See also *Castello v. Central Eureka Mining Co.*, (1948) 85 Cal. App.(2d) 772, 193 P.(2d) 968.

⁷¹ *Good v. Derr*, (1931) 46 F.(2d) 411; *Milton v. Bergstrom*, *supra* (Note 51).

⁷² *Speckert v. Bunker Hill Arizona Mining Co.*, (1940) 6 Wash.(2d) 39, 106 P.(2d) 602.

The consent of the stockholder to an assessment may sometimes be given indirectly. For example, if the corporation passes a by-law providing for an assessment, and a stockholder, with knowledge of that by-law and with full acquiescence, purchases shares of stock, he will be deemed to have agreed to the provisions of the by-law with regard to the assessment.⁷³ Of course, if the stockholder received his stock before the passage of the by-law fixing the assessment, it could not be said that he consented to the assessment if he did not concur in the passage of the by-law.⁷⁴

FORMS COVERING CALLS AND ASSESSMENTS

Form 747—Notice of call and receipt for payment.

....., 19....
To

You are hereby notified that a call of (\$.....) Dollars per share on all the shares of the Common Stock of the Corporation, payable on the day of, 19...., was made by a resolution of the Board of Directors of the said Corporation, duly passed on the day of, 19....

The amount due upon your subscription dated the day of, 19...., is (\$.....) Dollars, which you will please pay to the Corporation's Treasurer, at No., City of, State of, on or before the day of, 19....

When sending your check, please forward this notice, together with the form of receipt attached hereto.

By order of the Board of Directors.

.....
Secretary

RECEIPT FOR PAYMENT OF CALL
OF \$..... PER SHARE OF
COMMON STOCK DUE
....., 19....
..... Corporation

⁷³ Jonas v. Frost, (1919) 32 Idaho 214, 179 P. 949; Big Creek Ditch Co. v. Hulick, supra (Note 51); Gowans v. Rockport Irrigation Co., supra (Note 30).

⁷⁴ Sullivan County Club v. Butler, (1899) 26 N.Y. Misc. 306, 56 N.Y. Supp. 1.

RECEIVED, from, the sum of (\$.....)
 Dollars, being the amount due on (.....) shares of Common
 Stock in the above Corporation.

Treasurer

Form 748—Stockholders' waiver of notice of assessments.

The undersigned, subscribers to the capital stock of the
 Corporation, a corporation organized and existing under the laws of the
 State of, do hereby waive the statutory notice and all other
 notice of any kind whatsoever, of the time and place of payment of as-
 sessments on the shares of stock of said Corporation, subscribed by them
 and by each of them respectively, and do hereby severally agree to pay
 to the Treasurer of said Corporation, the amounts sub-
 scribed by them respectively, at such time and in such manner as the
 Board of Directors of said Corporation may require.

Dated this day of, 19....

.....

***Form 749—Notice to shareholders of postponement of due date of
 installments on subscriptions.***

..... COMPANY
 STREET
 CITY, ... STATE

....., 19....

To Our Shareholders:

On account of the extraordinary financial condition existing at the
 present time, and for the convenience of prospective subscribers to the
 stock of Company, the Board of Directors, at a meeting
 held today, decided to defer the date when payment of the second, third,
 and fourth installments will become due, to
, and respectively.

The first payment, however, will be payable on, in
 accordance with the original announcement.

Very truly yours,

.....

President

Form 750—Notice of forfeiture of payments made upon stock subscription for nonpayment of call (where sale is not required).

To

....., ...

You are hereby notified that the Board of Directors of the Corporation, at a meeting held on the day of, 19...., duly passed a resolution forfeiting your rights to the subscription for (.....) shares of the Common Stock of this Corporation, and, under the terms of such subscription, all payments heretofore made are likewise forfeited because of your failure to pay the call of (\$.....) Dollars per share due thereon, on the day of, 19....

.....
Secretary

Form 751—Notice of forfeiture of stock and sale for nonpayment of call.

To

....., ...

You are hereby notified that the Board of Directors of the Corporation, at a meeting held on the day of, 19...., duly passed a resolution forfeiting the (.....) shares of Common Stock having a par value of (\$.....) Dollars each, represented by Certificate No., of which you are the record owner, because of your failure to pay the call of (\$.....) Dollars per share due thereon on the day of, 19....

By order of the Board of Directors, said (.....) shares of Common Stock will be sold at public auction to the highest bidder at the office of the Corporation, No. Street, City of State of, or as many shares of said stock as will pay (\$.....) Dollars, which is the aggregate amount due on said shares, and also the costs of advertising and the expenses of the sale.

.....
Secretary

Form 752—Notice of assessment.

..... CORPORATION
..... STREET, ...

NOTICE IS HEREBY GIVEN That, at a meeting of the Board of Directors, held on the day of, 19...., an assessment of

(\$.....) Dollars per share was levied upon the capital stock of the Corporation, payable on the day of, 19...., to the Treasurer of the Corporation, at No., City of, State of Any stock upon which this assessment shall remain unpaid on the day of, 19...., will be delinquent and advertised for sale at public auction, and, unless payment is made before this date, will be sold on the day of 19...., to pay the delinquent assessment, together with the costs of advertising and the expenses of the sale.

.....
Secretary

Form 753—Notice of sale of stock for nonpayment of assessment.

..... CORPORATION
..... STREET, ...

There is delinquent upon the following-described stock, on account of the assessment levied on the day of, 19.... (and assessments levied previous thereto, if any), the several amounts set opposite the names of the respective shareholders, as follows:

Names	Number of	Number of	Amount
	Certificate	Shares	
.....			
.....			
.....			

And in accordance with law and an order of the Board of Directors, made on the day of, 19...., as many shares of each parcel of such stock may be necessary will be sold at the (*indicate particular place*), on the day of, 19...., at o'clock in the noon of such day, to pay delinquent assessments thereon, together with the costs of advertising and the expenses of the sale.

.....
Secretary

Form 754—Public notice of sale of stock for nonpayment of call.

Public notice is hereby given that (*.....*) shares of the capital stock of Corporation will be sold at public auction by the directors of said Corporation at the office of said Corporation, ... (*Street*), City of, State of, on the day of, 19...., at o'clock in the noon.

Said sale will be made pursuant to the statutes of the State of, and the By-laws of said Corporation, in such case made and provided, because of the nonpayment by, subscriber for said stock, of a call for the payment of an installment on the same for (.) days after said installment was due and payable, due notice thereof having been given.

. Corporation

By

Secretary

Dated at, ..., 19

Form 755—Notice of postponement of sale of stock for nonpayment of assessments.

. CORPORATION

. STREET

. CITY, ... STATE

., 19

By order of the Board of Directors, the date of the sale of stock for delinquent assessment has been postponed from the day of, 19, to the day of, 19, at o'clock in the noon.

.
Secretary

Form 756—Affidavit of secretary upon sale of stock for failure to pay assessment.

State of }
County of } ss.:

., being duly sworn, deposes and says that he is the Secretary of Corporation, a corporation organized and existing under the laws of the State of, and having its principal office at (Street), ... (City), ... (State).

That, on the day of, 19, a notice of sale of delinquent stock, a copy of which is annexed hereto and made a part of this affidavit, was duly served upon the stockholders hereinbelow named, by mailing to each of them at his last known post-office address, a true copy thereof, and that, as appears from the affidavit of, annexed hereto, said notice was duly published as required by law.

That, pursuant to said notice of sale, and at the time and place designated therein, your deponent caused to be sold through, a licensed auctioneer, the following shares of stock of said Corporation, represented by the certificates hereinafter set forth:

<i>Certificate No.</i>	<i>No. of Shares</i>	<i>Standing in the Name of</i>
.....		
.....		
.....		

CHAPTER 21

CHANGES IN CAPITAL STOCK STRUCTURE

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PRÉEMPTIVE RIGHTS OF STOCKHOLDERS

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Changes in Capital Stock Structure

Increase of capital stock. In most states the corporation law requires that the charter specify the authorized number and par value of shares having par value, and the authorized number of shares that will not have par value.¹ Thus, if a corporation desires to increase the authorized number or par value of its shares, it is necessary to amend the articles of incorporation.² Some states require that a certificate of increase be filed with a designated authority.³ An issuance of shares beyond the limitations of the charter is an overissue and such shares will be void.⁴ Changes in the number of shares is often a basis for state taxation and should be considered prior to authorizing an increase.⁵

Power to increase stock. In each state there are statutory provisions conferring on corporations organized under its laws the right to increase their authorized capital stock with the consent of the stockholders. If there were no express statutory authority from the state, a corporation would have no right to increase its authorized capital stock.⁶ The authority to increase may be conferred on the corporation: (1) by the general laws under which it was organized; and (2) by its charter or articles of incorporation, under authority of general laws.

There is no such thing as an implied authority to increase the capital stock.⁷ The authority must be express.⁸ In some states, the extent

¹ See *Prentice-Hall Corporation* for a collection of such statutes.

² *Farmers' & Traders' Bank v. National Laundry & Linen Supply Co.*, (1917) 30 Idaho 788, 168 P. 670; *Uffelman v. Boillin*, (1935) 19 Tenn. App. 1, 82 S.W.(2d) 545; *First Ave. Land Co. v. Parker* (1901) 111 Wis. 1, 86 N.W. 604.

³ This requirement may be in addition to amending the articles or, in some states, it may be done instead of amending the articles. Publication may also be required.

⁴ *In re R. Rombach & Co.*, (1926) 9 F.(2d) 359; *Larsen v. The Lilly Estate*, (1949) 34 Wash.(2d) 39, 208 P.(2d) 150, 10 A.L.R.(2d) 580.

⁵ *California Tel. & Light Co. v. Jordan*, (1912) 19 Cal. App. 536, 126 P. 598; *Hood Rubber Co. v. Commonwealth*, (1921) 238 Mass. 369, 131 N.E. 201.

⁶ *Star Publishing Co. v. Ball*, (1922) 192 Ind. 158, 134 N.E. 285.

⁷ *Randell v. Mickle*, (1931) 103 Fla. 1229, 138 So. 14, 141 So. 317.

⁸ *Einstein v. Rochester Gas & Elec. Co.*, (1895) 146 N.Y. 46, 40 N.E. 631.

to which capital stock may be increased is limited. The power to authorize an increase in the capital stock of a corporation ordinarily rests with the stockholders. A change so organic and fundamental as that of enlarging the capital stock of the corporation beyond the limit fixed by the charter cannot be made by the directors alone, unless the power is expressly conferred upon them.⁹ Even where the charter of the corporation fails to state by whom the power to increase its capital stock is to be exercised, its directors have not, merely by virtue of their position as directors, the power to do so.¹⁰ In the absence of statutory provision to the contrary, authority to increase the stock may be conferred on the board of directors by charter or by charter amendments.

Method of increasing capital stock. The general laws under which most corporations are now organized authorize the increase of capital stock and indicate the method to be followed. In many instances, an amendment of the articles of incorporation is required. The board of directors passes a resolution at a duly called meeting, recommending the increase, and calling a meeting of the stockholders to take action on the amendment. The stockholders' meeting is usually required to be called upon notice setting forth the nature of the proposed action. Failure to give notice of the meeting at which an increase of the capital stock is voted invalidates the attempted increase.¹¹ Articles of amendment certifying to the increase are then filed, as in the case of other amendments (see page 185).

In some states, instead of requiring an amendment of the articles of incorporation to effect an increase in capital stock, an instrument, generally called a certificate of increase, is required to be filed. The procedure is practically the same as in the case of an increase by amendment of the charter, except that instead of filing the articles of amendment, a certificate is recorded with the designated state or county authorities. This certificate, signed by an officer of the corporation, sets forth the details of the increase and certifies that the required vote for authorizing the increase has been obtained.

⁹ *Eidman v. Bowman*, (1871) 58 Ill. 444, 11 Am. Rep. 90. See also *Scovill v. Thayer*, (1881) 105 U.S. 968.

¹⁰ *McNulta v. Corn Belt Bank*, (1897) 164 Ill. 427, 45 N.E. 954.

¹¹ *Danzig v. Lacks*, (1932) 235 App. Div. 189, 256 N.Y. Supp. 769.

Under the blue-sky laws in force in some states, authority to issue increased stock must be obtained from some commission or officer of the state. Similarly, under the federal law, registration of the securities may be required before the increased stock may be sold or offered for sale through the mails or through the channels of interstate commerce.¹²

Effect of overissue and failure to comply with statutory requirements in effecting increase of stock. Any issue of shares in excess of the charter limit is void even in the hands of a bona fide purchaser¹³ and can not be validated by a subsequent amendment to the charter which purports to ratify the increase.¹⁴ The corporation, or a stockholder for himself and other stockholders, if the corporation refuses to act, may sue for a cancellation of certificates issued pursuant to an overissue of stock.¹⁵ The corporation will be liable for damages suffered as a result of the invalidity by a person who purchases the shares.¹⁶ A subscription contract to purchase these shares cannot be enforced.¹⁷ Thus, a corporation's efforts to raise additional capital by an overissue will result in nothing more than the creation of unenforceable subscription contracts or the creation of a class of creditors whose claims are immediately due.

Since an omission of any essential step prescribed by statute or the charter for increasing the number or par value of authorized shares, will entitle subscribers to avoid their subscription contract or claim damages for receiving void stock,¹⁸ care should be taken in observing the statutory requirements. The most common mistakes that have caused shares to be invalid are:

1. Failure to hold a valid stockholder meeting with the requisite notice to all stockholders who are entitled to vote.¹⁹

¹² See Prentice-Hall *Securities Regulation*.

¹³ *Scovill v. Thayer*, (1881) 105 U.S. 968; *In re R. Rombach & Co.*, *supra* (Note 4); *Taylor v. Lounsbury-Soule Co.*, (1927) 106 Conn. 41, 137 A. 159.

¹⁴ *Rice & Hutchins v. Triplex Shoe Co.*, (1930) 17 Del. Ch. 356, 152 A. 342. *Contra*: *Cantor v. Pinsley*, (1950) 100 N.Y.S.(2d) 533.

¹⁵ *Jutte v. Hutchinson*, (1899) 189 Pa. St. 218, 42 A. 123.

¹⁶ *National Bank of Webb City v. Newell-Morse Royalty Co.*, (1914) 258 Mo. 637, 168 S.W. 699; *Hobson v. Marsh*, (1912) 69 Wash. 326, 124 P. 912.

¹⁷ *In re R. Rombach & Co.*, *supra* (Note 4); *Taylor v. Lounsbury-Soule Co.*, *supra* (Note 13); *Larkin v. Maclellan*, (1922) 140 Md. 570, 118 A. 181; *Danzig v. Lacks*, (1932) 235 App. Div. 189, 256 N.Y. Supp. 769.

¹⁸ *Ibid.*

¹⁹ *Farmers' & Traders' Bank v. National Laundry & Linen Supply Co.*, *supra* (Note 2).

2. Failure to adopt a resolution at a meeting of the board of directors.²⁰

3. Failure to file a certificate with the authority designated by statute.²¹

As between the corporation and the state, these requirements are mandatory and strict compliance is essential.

As between the stockholder and the corporation, it is necessary, in order to determine the validity of the stock, to distinguish between the omission of steps necessary to give the corporation the power to make the increase and those which are mere minor defects or irregularities in procedure.²² The state alone may raise the question of irregularity.²³ If the power to make the increase exists, substantial compliance is sufficient to make the issue valid as to the stockholder, particularly if the stockholder has received benefits or otherwise enjoyed his rights as a stockholder.²⁴ The following have been held to be mere irregularities not affecting the validity of an increase:

1. Failure to give formal notice of the meeting to all stockholders, when, in fact, all the stockholders had approved the increase.²⁵

2. Failure to file a required certificate.²⁶

3. Failure to publish a charter amendment authorizing the increase.²⁷

However, if the issue is entirely unauthorized, stockholders can question the increase even though they attended the meeting at which the resolution increasing the stock was passed.²⁸ Where the

²⁰ *Farmers' & Traders' Bank v. National Laundry & Linen Supply Co.*, supra (Note 2); *Bell Isle Corp. v. Mac Bean*, (1946) 27 Del. Ch. 261, 49 A.(2d) 5.

²¹ *Dingle v. Schaab*, (1941) 79 Md. 589, 20 A.(2d) 148. But see *Larkin v. Maclellan*, supra (Note 17).

²² This distinction assumes crucial importance to the shareholder in a suit by creditors of the corporation for the unpaid portion of the purchase price or for any further assessment provided for in the shareholder's contract.

²³ *In re Rombach & Co.*, supra (Note 4).

²⁴ *Mitchell v. Mitchell Woodbury Co.*, (1928) 263 Mass. 160, 160 N.E. 539 (certificate incorrectly stated new stock was to be issued for cash).

²⁵ *Larkin v. Maclellan*, supra (Note 17); *Garnett v. State, ex rel. Bank Comm'r*, (1932) 162 Okla. 195, 19 P.(2d) 375.

²⁶ Validity was not affected as to those participating or acquiescing in the increase. *Jackson v. Pittsburgh, F. W. & C. Ry.*, (1921) (Ind. App.) 132 N.E. 710.

²⁷ *Handley v. Stutz*, (1890) 139 U.S. 417, 11 S. Ct. 530.

²⁸ *Tschumi v. Hills*, (1897) 6 Kan. App. 549, 51 P. 619 (board passed increase without charter amendment).

corporation lacks the power to make the increase, the acquiescence of the shareholder cannot bind him.²⁹

Reduction of capital stock.³⁰ Since the number and par value of shares is usually required to be mentioned in the articles of incorporation, it is necessary to amend the articles to reduce this number. Not every reduction, in capital stock, however, is effectuated by charter amendment.³¹

In the absence of statutory authority, a corporation is without power to decrease its capital stock by charter amendment.³² The power is usually conferred under a general statutory power to amend the articles of incorporation. Some states, however, have separate provisions for the decrease of capital stock.³³

Ways of reducing capital stock. If permitted under the law of the state of incorporation, a reduction of capital stock by the corporation may be accomplished by the following methods.³⁴

1. A purchase of outstanding shares for cancellation or retirement. The shares may be acquired by:
 - a. Purchasing shares drawn by lot.
 - b. Purchasing shares pro rata from all the stockholders.
 - c. Purchasing shares in the open market.

²⁹ *Scovill v. Thayer*, *supra* (Note 13).

³⁰ For purposes of this chapter the term capital stock means only the aggregate par value of outstanding par value shares plus the total consideration received, or to be received, or transferred from surplus in payment of shares which have no par value. Sums which are originally received for the stock which are allocated to surplus are not included within this definition. One should be cautioned, however, that the term capital stock is sometimes used in many different senses. See, Gose, "Legal Significance of 'Capital Stock,'" 32 WASH. L. REV. 1.

³¹ For example, a transfer to the surplus account of funds previously allocated to capital would not necessarily require a charter amendment.

³² *Botz v. Helvering*, (1943) 134 F.(2d) 538; *Security Nat'l Bank v. Crystal Ice & Fuel Co.*, (1937) 145 Kan. 899, 67 P.(2d) 527; *Williams v. Davis*, (1944) 297 Ky. 626, 180 S.W.(2d) 874; *State v. Louisiana Navigation & Fisheries Co.*, (1942) La., 8 So.(2d) 796; *Hildreth v. Western Realty Co.*, (1932) 62 N.D. 233, 242 N.W. 679; *A. B. Frank Co. v. Latham*, (1946) 145 Tex. 30, 193 S.W.(2d) 671.

³³ See *Prentice-Hall Corporation* for specific statutory provisions.

³⁴ Not all of these methods have the same financial and legal consequences. The method selected should be determined in the light of the financial results desired and the legal restrictions that regulate or prohibit the various methods. Very generally, it may be said that the law prohibits a disbursement of assets to the owners of the corporation if the rights of creditors will thereby be materially impaired. The law also prohibits changes in capital structure that treat shareholders unequally without justification, unless, of course, such treatment is authorized by statute or by the shareholder's contract with the corporation.

- d. Purchasing shares pursuant to an agreement between the corporation and the shareholders made at the time of the original sale.³⁵
2. Exchanging par value shares if the shares tendered by the corporation have a smaller par value.
3. Exchanging par value shares for a lesser number of shares having the same par value.
4. Exchanging par value shares for no-par value shares, if the consideration allocated to the no-par shares is less than the aggregate par value of the par value shares.
5. Exchanging no-par value shares for par value shares, if the consideration allocated to the no-par shares is greater than the aggregate par value of the par value shares.
6. Transferring funds from the capital account to the surplus account.
7. Releasing subscribers from their contractual liability to pay for their shares.
8. Retiring treasury stock. (Strictly speaking, this will not reduce capital stock, but it will reduce the possibility of increasing capital stock in the future.)

The statutes in some states specifically authorize the reduction of capital stock in one or more of these ways, and indicate the procedure to be followed in effecting the reduction.

Power to reduce capital stock. In the absence of express statutory authority, a corporation is without power to decrease its authorized capital stock.³⁶ Authority to reduce cannot even be implied from an authority to increase.³⁷ Express authority to decrease capital stock exists in most states, however, either by virtue of the power to amend the articles of incorporation, or by separate provisions for the decrease of capital stock.

³⁵ But see *Botz v. Helvering*, *supra* (Note 32). Under a Missouri statute, the court held that a corporation could not effect a reduction by carrying out a repurchase contract. Such a contract is unenforceable, if, at the time the repurchase is to be made, the corporation is insolvent or the repurchase will impair the capital of the corporation. See page 911.

³⁶ See *Hildreth v. Western Realty Co.*, *supra* (Note 32); *Security Nat'l Bank v. Crystal Ice & Fuel Co.*, *supra* (Note 32). See also Note 30 *supra*.

³⁷ *Seignouret v. Home Ins. Co.*, (1885) 24 F. 332.

As in the case of an increase of capital stock, the directors have no power to effect a reduction unless authorized by the statute, by the articles of incorporation, or by the stockholders. In the absence of a statutory provision, any diminution of the capital stock fixed in the certificate of incorporation is a fundamental change, requiring the unanimous consent of the stockholders. Not even all the stockholders, however, can reduce the authorized capital stock if the rights of creditors are prejudiced thereby.³⁸

Most of the states require that a reduction in stock be authorized by either a majority or a two-thirds vote of the stockholders at a meeting called upon due notice.

Procedure to reduce capital stock. The statutes authorizing a reduction in capital stock generally indicate the procedure to be followed in carrying out the reduction. Usually an amendment of the charter is required. However, as in the case of an increase in the capital stock, a decrease may in some states be effected by means of a certificate of decrease rather than by an amendment of the articles of incorporation. The decrease is voted upon at a stockholders' meeting, and a certificate is filed and recorded with the proper authorities.³⁹ In some states, the written assent of stockholders is sufficient, and no stockholders' meeting is required.

Stockholders' rights upon reduction of capital stock. In the absence of express statutory provision to the contrary, the right of the individual stockholder to a proportionate voice in the conduct of the affairs of the corporation, and to an equitable interest in the corporate property, a right to which he is entitled when he becomes a stockholder, must be preserved. Accordingly, if stock is reduced, it must be done in such a way that a stockholder will have the same proportionate interest in the corporation that he had before the retirement.⁴⁰ Each stockholder should be allowed to surrender such pro-

³⁸ *Johnson v. Tribune-Herald Co.*, (1923) 155 Ga. 204, 116 S.E. 810. See also *Kraft v. Rochambeau Holding Co.*, (1956) 210 Md. 325, 123 A.(2d) 287.

³⁹ Where, upon reduction of capital stock by purchase of its shares, the corporation failed to file the requisite certificate or to make the requisite publication, it was held that the corporation could not later set up its own failure to comply with the statutory requirements in an effort to set aside the purchase. *Security Nat'l Bank v. Crystal Ice & Fuel Co.*, *supra* (Note 32).

⁴⁰ *Page v. American and British Mfg. Co.*, (1908) 129 App. Div. 346, 113 N.Y. Supp. 734; *Hildreth v. Western Realty Co.*, *supra* (Note 32).

portion of his stock as the amount of the proposed reduction bears to the whole amount of the capital stock.⁴¹ If the corporation purchases stock for retirement, it should be acquired ratably from each stockholder who desires to sell.⁴² After a valid reduction, the corporation can require a stockholder to accept a certificate for a fractional part of the shares originally held by him.⁴³ If the corporate stock is divided into preferred and common stock, there must be a reduction of both in the proportion that the issue of one bears to the issue of the other, unless the statute provides otherwise.⁴⁴ All the stockholders may, however, consent to a reduction in an unequal proportion. These statements have no application, of course, where, under statutory authority, different methods may be pursued to effect a reduction. Upon compliance with the statute, a reduction of any class of stock may be effected even if it results in a change of a stockholder's interest in the corporation.

In some states, the statutes specifically provide that any class of stock may be reduced. The vote of each class of stockholders is sometimes required to effect a reduction.

Creditors' rights upon reduction of capital stock. Even with statutory authority, the corporation cannot reduce its authorized capital stock to the prejudice of existing creditors. The statutes in many states provide, expressly or by implication, that a reduction of the authorized capital stock cannot be made if it will impair the corporation's ability to meet its obligations.⁴⁵ In some states, such impairment is made a criminal offense.

A reduction of stock cannot relieve those who were stockholders at the time of the reduction, from their liability to existing creditors for unpaid subscriptions. For example, if a corporation having a fixed

⁴¹ *Currier v. Lebanon Slate Co.*, (1875) 56 N.H. 262.

⁴² *Ocean City Title & Trust Co. v. Strand Properties, Inc.*, (1930) 106 N.J. Eq. 25, 149 A. 817, *aff'd*, 107 N.J. Eq. 594, 153 A. 906; *General Inv. Co. v. Bethlehem Steel Corp.*, (1917) 87 N.J. Eq. 234, 100 A. 347. This does not mean, however, that a corporation cannot purchase its own stock in the open market. *Downs v. Jersey Central Power & Light Co.*, (1934) 115 N.J. Eq. 448, 171 A. 306. But see *Security Nat'l Bank v. Crystal Ice and Fuel Co.*, *supra* (Note 32).

⁴³ *Perry v. Bank of Commerce*, (1919) 118 Miss. 852, 80 So. 332.

⁴⁴ *Page v. American and British Mfg. Co.*, *supra* (Note 40).

⁴⁵ For a discussion of the rights of creditors upon the reduction of capital stock, under the various statutes, see 47 HARV. L. REV. 693.

capital stock of \$20,000, all of which has been issued and is outstanding, has received payment of only \$10,000 on account from stockholders, the corporation cannot reduce its capital stock to \$10,000 and relieve the stockholders from payment of the balance due from them, to the prejudice of creditors. Subsequent creditors, however, cannot complain of a prior reduction,⁴⁶ nor can they hold liable stockholders to whom fully paid stock has been issued.⁴⁷ A corporation cannot reduce its capital stock by purchasing the stock of a delinquent stockholder and excusing him from payment of an assessment on his stock.⁴⁸

After a reduction of the authorized capital, there must remain available assets equal to the issued capital stock plus the amount necessary to cover all liabilities. The reduction must not effect an impairment of capital. If, after a valid reduction, an excess of funds remains over and above the required amount indicated, it may be distributed by the corporation to its stockholders as surplus.⁴⁹

Reclassification of stock. A reclassification of stock may be brought about: (1) by the issuance of one or more additional classes of stock,⁵⁰ or (2) by changing the number of shares, par value, designations, preferences, or relative participating, optional, or other special rights of existing shares, or the qualifications, limitations, or restrictions of such rights.⁵¹ The statutes in some states authorize such

⁴⁶ *Rice v. Thomas*, (1919) 184 Ky. 168, 211 S.W. 428.

⁴⁷ *In re State Ins. Co.*, (1882) 14 F. 28.

⁴⁸ *Currier v. Lebanon Slate Co.*, *supra* (Note 41).

⁴⁹ *Benas v. Title Guaranty & Trust Co.*, (1924) 216 Mo. App. 53, 267 S.W. 28; *Jay Ronald Co., v. Marshall Mortgage Corp.*, (1943) 291 N.Y. 227, 52 N.E.(2d) 108, discussed in 29 CORNELL L.Q. 114; *Strong v. The Brooklyn Cross-Town R.R.*, (1883) 93 N.Y. 426; *Page v. American & British Mfg. Co.*, *supra* (Note 40); *Chisnell v. Ozier Co.*, (1942) 140 Ohio St. 355, 44 N.E.(2d) 464.

⁵⁰ See *In re Kinney*, (1939) 279 N.Y. 423, 18 N.E.(2d) 645, discussed in 52 HARV. L. REV. 1011, 39 COLUM. L. REV. 1037.

Issuance of prior preference stock with precedence over existing preferred stock was upheld in *General Inv. Co. v. American Hide & Leather Co.*, (1925) 98 N.J. Eq. 326, 129 A. 244. See also *Haar v. Pioneer Mechanical Corp.*, (1933) 65 F.(2d) 332, mod., 2 F. Supp. 517, cert. denied, 54 S. Ct. 92, discussed in 28 ILL. L. REV. 422; *Shanik v. White Sewing Mach. Corp.*, (1940) 25 Del. Ch. 371, 19 A.(2d) 831, lower court opinion discussed in 7 U. PITT. L. REV. 326.

⁵¹ A corporation was held to have the right under the statute to amend its charter so as to change 7% cumulative preferred stock to a new 5% stock. *Harbone v. Dayton Malleable Iron Co.*, (1939) 61 Ohio App. 1, 22 N.E. 281, discussed in 6 OHIO ST. L.J. 313.

The probabilities of a dividend payment to a certain class of stock can be reduced

reclassification upon the vote or consent of a specified proportion of the stockholders.⁵² In most instances, an amendment of the charter is required, since the various classes into which the capital stock is divided are fixed in the charter. In some states, however, a change in classification may be effected by filing with designated state authorities a certificate, duly executed and signed by the officers of the corporation. In some states, a stockholder dissenting from an alteration in the preferential rights attaching to his stock is entitled to an appraisal of his shares.⁵³

PREEMPTIVE RIGHTS OF STOCKHOLDERS

Meaning of preëptive right. The right of a stockholder, upon the issuance by the corporation of additional shares of stock, to subscribe for and demand from the corporation such a proportion of the new stock as the number of shares already owned by him bears to the total number of shares previously issued, is called the stockholder's "preëptive" right. This right is based upon two principles: (1) that

by charter amendment creating a class of stock with priority over the existing class, if such an amendment is permitted by statute. *Johnson v. Fuller*, (1940) 36 F. Supp. 744, aff'd, 121 F.(2d) 618, discussed in 27 VA. L. REV. 954; *Shanik v. White Sewing Mach. Corp.*, supra (Note 50).

See also *Albrecht, Maguire & Co. v. General Plastics*, (1939) 256 App. Div. 134, 9 N.Y.S.(2d) 415, aff'd, 280 N.Y. 840, 21 N.E.(2d) 887, discussed in 25 CORNELL L.Q. 124, (1940); *Breslav v. New York & Queens Elec. Light & Power Co.*, (1936) 249 App. Div. 181, 291 N.Y. Supp. 932, discussed in 46 YALE L.J. 1055; *Davison v. Parke, Austin & Lipscomb*, (1940) 173 N.Y. Misc. 782, 19 N.Y.S.(2d) 117, discussed in 16 TEMP. L.Q. 93.

⁵² See the following cases in which reclassification by the required proportion was involved: *Barrett v. Denver Tramway Corp.*, (1944) 53 F. Supp. 198, aff'd, (1944) 146 F.(2d) 701, discussed in 54 YALE L.J. 840; *McQuillen v. National Cash Register Co.*, (1939) 27 F. Supp. 639, aff'd, (1940) 112 F.(2d) 877, cert. denied, (1940) 311 U.S. 695, 61 S. Ct. 140, rehearing denied, (1940) 311 U.S. 729, 61 S. Ct. 316, discussed in 54 HARV. L. REV. 754; *Sellers v. Joseph Bancroft & Sons*, (1938) 23 Del. Ch. 13, 2 A.(2d) 108, discussed in 37 MICH. L. REV. 803.

⁵³ See *In re Silberkraus*, (1929) 250 N.Y. 242, 165 N.E. 279 and *Matter of Seiler*, (1933) 239 App. Div. 400, 267 N.Y. Supp. 567, interpreting such a statute. Under such a statute, the creation of a new class of stock with preferences prior to existing preferred stock was held not to be a change in preferential rights. *In re Dresser*, (1928) 247 N.Y. 553, 161 N.E. 779, aff'g 221 App. Div. 786, 223 N.Y. Supp. 864. To same effect, *In re Kinney*, supra (Note 50). This case held, however, that a transfer from capital to surplus did constitute an alteration entitling the stockholder to an appraisal of his shares. See also *McNulty v. W. & J. Sloane*, (1945) 184 N.Y. Misc. 835, 54 N.Y.S.(2d) 253, discussed in 20 N.Y.U.L.Q. REV. 509 and in 54 YALE L.J. 840.

See 42 YALE L.J. 952, in which the subject of capital reclassification as an alteration of preferential rights under appraisal statutes is discussed.

existent stockholders must be given an opportunity to keep proportionate control; and (2) that the equities of the stockholders in the surplus of the corporation must be preserved. Thus, a corporation that increases its capital stock 25 per cent must allow each stockholder the right to subscribe to the new issue up to 25 per cent of his holdings. *A*, owning 5000 shares of an authorized issue of 50,000 shares of common stock, upon a 50 per cent increase in the common stock will be entitled to subscribe to 2500 shares of the new stock at the price fixed, before the stock may be offered to any outsider.

Each stockholder having a preemptive right must be given reasonable notice of his right to subscribe and an opportunity to obtain his proportionate share in the increase of the capital stock upon the same terms as the other stockholders.⁵⁴ Stockholders who are not in a position to take and pay for the stock to which they are entitled may sell the rights to anyone who is able to take and pay for the stock.⁵⁵

Issues of stock to which the preemptive right applies. The statutes in some states contain provisions governing the preemptive right of stockholders. These statutes indicate the kind of issues to which the preemptive right attaches, and in some instances provide that the certificate of incorporation may deny the preemptive right to any issue or to any class of stock. In the absence of statutory provisions, however, reference must be made to the various decisions that have developed the doctrine of preemptive rights, to determine whether or not such rights exist.⁵⁶ The generally accepted rules applicable to various situations and the cases on which these rules are based, are given below.

The rule of preemptive right is subject to the general restriction

⁵⁴ *Hoyt v. Great American Ins. Co.*, (1922) 201 App. Div. 352, 194 N.Y. Supp. 449. See also *Bennett v. Baum*, (1911) 90 Neb. 320, 133 N.W. 439 in which it was held that a five days' notice was not reasonable.

⁵⁵ *Stokes v. Continental Trust Co.*, (1906) 186 N.Y. 285, 78 N.E. 1090; *Schramme v. Cowin*, (1923) 205 App. Div. 20, 199 N.Y. Supp. 98.

⁵⁶ The decisions of the different states are not in accord. For a discussion of the leading cases on the subject, see Morawetz, "The Preemptive Right of Shareholders," 42 HARV. L. REV. 186; Drinker, "The Preemptive Rights of Shareholders to Subscribe to New Shares," 43 HARV. L. REV. 586; Hills, "Preemptive Right of Preferred Stockholders to Subscribe to New Stock," 5 N.Y.U.L. REV. 207; Dwight, "The Right of Stockholders to New Stock," 18 YALE L.J. 101; Frey, "Shareholders' Preemptive Rights," 38 YALE L.J. 563. See also 53 MICH. L. REV. 595; 11 N.Y.U.L.Q. REV. 78; Gerstenberg, *Financial Organization and Management of Business*, Prentice-Hall, Inc., 3rd rev. ed., 1951, p. 295 et seq.

that its application must be consistent with the object for which the stock is to be issued.⁵⁷ Thus, the right usually is not recognized when new stock is issued for property, to wipe out debts and claims against the corporation,⁵⁸ to secure a loan,⁵⁹ or to obtain employees' services.⁶⁰

Preéemptive right upon original issue of stock. No preéemptive rights exist upon an original issue of stock made at a time when a corporation is being organized. However, if instead of immediately disposing of its entire issue of original stock, the corporation retains a part for issuance at a later date when it is in need of additional capital, the question arises as to whether or not existing stockholders have a right to purchase a proportionate part of the unissued shares.⁶¹ Different conclusions have been reached by different courts. Some courts limit the preéemptive right to an increase in authorized capital only and hold that preéemptive rights do not exist in capital stock of an original issue.⁶² Thus, the preéemptive right of existing stockholders is not violated when voting stock, which is part of the original capital stock, is issued to the general manager four years after incorporation.⁶³ Yet other courts hold that, in the absence of a contrary statute, a stockholder has a preéemptive right to purchase shares upon a delayed issuance of original stock.⁶⁴ It has also been held that while

⁵⁷ *Todd v. Maryland Cas. Co.*, (1946) 155 F.(2d) 29; *Thom v. Baltimore Trust Co.*, (1930) 158 Md. 352, 148 A. 234; *Milwaukee Sanitarium v. Swift*, (1941) 238 Wis. 628, 300 N.W. 760.

⁵⁸ *Dunlay v. Ave. M Garage & Repair Co.*, (1930) 253 N.Y. 274, 170 N.E. 917, discussed in 29 MICH. L. REV. 107.

⁵⁹ *Todd v. Maryland Cas. Co.*, *supra* (Note 57).

⁶⁰ *Milwaukee Sanitarium v. Swift*, *supra* (Note 57).

⁶¹ *Kingston v. Home Life Ins. Co.*, (1917) 11 Del. Ch. 258, 101 A. 898, *aff'd & mod'd*, 11 Del. Ch. 428, 104 A. 25.

⁶² *Schwab v. Schwab-Wilson Mach. Corp.*, (1936) 13 Cal. App.(2d) 1, 55 P.(2d) 1268; *Archer v. Hesse*, (1914) 164 App. Div. 493, 150 N.Y. Supp. 296.

⁶³ *Yasik v. Wachtel*, (1941) 25 Del. Ch. 247, 17 A.(2d) 309.

⁶⁴ *Titus v. Paul State Bank*, (1919) 32 Idaho 23, 179 P. 514. See also *Snelling v. Richard*, (1909) 166 F. 625; *Crosby v. Stratton*, (1902) 17 Colo. App. 212, 68 P. 130; *Rowland v. Times Publishing Co.*, (1948) 160 Fla. 465, 35 So.(2d) 399; *Public Bancorporation v. Atlantic City Wimsett Thrift Co.*, (1932) 110 N.J. Eq. 23, 158 A. 729; *Glenn v. Kittanning*, (1918) 259 Pa. 510, 103 A. 340; *Thurmond v. Paragon Colliery Co.*, (1918) 82 W. Va. 49, 95 S.E. 816; *Levy v. Sattler*, (1919) 169 Wis. 308, 172 N.W. 738.

It has been stated in *Drinker*, "The Preéemptive Right of Shareholders to Subscribe to New Shares," 43 HARV. L. REV. 586, that the "proper test is not whether the shares were original or subsequently authorized, but whether they are a part of the capital with which it was contemplated to launch the enterprise, in which all, whether joining first or last, might properly count on obtaining and keeping a proportionate part." See also *Federal Reserve Life Ins. Co. v. Gregory*, (1931) 132 Kan. 129, 294 P. 859.

ordinarily no preemptive right exists in respect to an original issue of stock, circumstances may create such a right,⁶⁵ as for example, where the stock is issued a long time after the corporation has commenced business,⁶⁶ and the proceeds of the issue are to be used for the purposes of business expansion.⁶⁷

Preemptive right upon increase of authorized stock. The rule that the additional shares of stock authorized by an increase may not be issued before a reasonable opportunity to take a proportionate amount of such shares is first offered to all existing stockholders is generally limited to an increased issue of voting, participating common or preferred stock.⁶⁸ This is on the theory that holders of shares of the original issue of nonvoting, nonparticipating stock who have no control and no interest in the corporate surplus, cannot be affected by a failure to give them the right to subscribe to shares of a new issue of the same class in proportion to their holdings in the original issue.⁶⁹ It has also been held that the preemptive right does not apply in favor of stockholders of a corporation that absorbs another corporation, when new shares are issued to stockholders of the corporation absorbed as part of the amalgamation process.⁷⁰

Preemptive rights upon issuance of treasury stock. It is generally recognized that shares which have been acquired by the corporation out of surplus, with a view to their subsequent reissue, may be reissued by the directors, in good faith and for value, without first being offered to existing stockholders.⁷¹ The statutes in some states

⁶⁵ See *Canada Southern Oils, Ltd. v. Manabi Exploration Co.*, (1953) 33 Del. Ch. 537, 96 A.(2d) 810.

⁶⁶ *Ross Transport v. Crothers*, (1946) 185 Md. 573, 45 A.(2d) 267; *Luther v. C. J. Luther Co.*, (1903) 118 Wis. 112, 94 N.W. 69.

⁶⁷ *Dunlay v. Ave. M Garage & Repair Shop*, *supra* (Note 58).

⁶⁸ *Bellows v. Porter*, (1952) 201 F.(2d) 429; *Hyman v. Velsicol Corp.*, (1951) 342 Ill. App. 489, 97 N.E.(2d) 122; *Gord v. Iowa Farms Milk Co.*, (1953) 245 Iowa 1, 60 N.W.(2d) 820; *Stokes v. Continental Trust Co.*, (1906) 186 N.Y. 285, 78 N.E. 1090; *Albrecht, Maguire & Co. v. General Plastics, Inc.*, (1939) 256 App. Div. 134, 9 N.Y.S.(2d) 415; *Maguire v. Osborne*, (1957) 388 Pa. 121, 130 A.(2d) 157. See also *Wall v. Utah Copper Co.*, (1905) 70 N.J. Eq. 17, 62 A. 533.

⁶⁹ *Yoakam v. Providence Biltmore Hotel Co.*, (1929) 34 F.(2d) 533; *General Inv. Co. v. Bethlehem Steel Corp.*, (1917) 88 N.J. Eq. 237, 102 A. 252.

⁷⁰ *Thom v. Baltimore Trust Co.*, *supra* (Note 57); *Bingham v. Savings Inv. & Trust Co.*, (1928) 101 N.J. Eq. 413, 140 A. 321; *Bonnet v. First Nat'l Bank*, (1900) 24 Tex. Civ. App. 613, 60 S.W. 325. See also 30 COLUM. L. REV. 569.

⁷¹ *Borg v. International Silver Co.*, (1926) 11 F.(2d) 147; *Crosby v. Stratton*, *supra* Note 64; *Runswick v. Floor*, (1949) 116 Utah 91, 208 P.(2d) 948; *Upton v. Southern*

specifically deny the preemptive right upon the issuance of treasury shares. The directors, however, must not obtain any undue advantage for themselves by the issuance of such treasury shares;⁷² they must give the other stockholders a chance to purchase the stock under the same terms and conditions as the directors are afforded.⁷³

Preemptive rights upon issuance of stock for property or services.

The general rule is that no preemptive rights exist in stock issued for services or for property.⁷⁴ Thus, if the directors have power to issue additional shares for property or services rendered, they can issue the shares for that purpose without giving the stockholders an opportunity to subscribe to them.⁷⁵ This rule, which has been much criticized,⁷⁶ is defended on the ground of practical necessity.⁷⁷ But the issuance of stock for property must be made at a fair value, and cannot be employed as a means of granting voting control to a particular stockholder.⁷⁸ The statutes in some states specifically deny the preemptive right where stock is issued for a consideration other than cash.

Persons in whom preemptive rights are vested. Generally preemptive rights are vested in those who are stockholders of record at the time the corporation determines to increase the stock in the manner required by law.⁷⁹ In some states, there are statutes providing for

Produce Co., (1926) 147 Va. 937, 133 S.E. 576; *Thurmond v. Paragon Colliery Co.*, supra (Note 64). Contra: *Dunn v. Acme Auto & Garage Co.*, (1918) 168 Wis. 128, 169 N.W. 297.

⁷² *Anderson v. Albert & J. M. Anderson Mfg. Co.*, (1950) 325 Mass. 343, 90 N.E.(2d) 541; *Hammer v. Werner*, (1933) 239 App. Div. 38, 265 N.Y. Supp. 172. See also "The Legal Status of Treasury Shares," 85 U. PA. L. REV. 622.

⁷³ *Kullgren v. Navy Gas Supply Co.*, (1943) 110 Colo. 454, 135 P.(2d) 1007, citing *Fosgate Co. v. Boston Market Terminal Co.*, (1931) 275 Mass. 99, 175 N.E. 86.

⁷⁴ *Thom v. Baltimore Trust Co.*, supra (Note 57); *Meredith v. New Jersey Zinc & Iron Co.*, (1897) 55 N.J. Eq. 211, 37 A. 539, aff'd, memo dec., 56 N.J. Eq. 454, 41 A. 1116; *Stokes v. Continental Trust Co.*, supra (Note 68); *Thomas Branch & Co. v. Riverside & Dan River Cotton Mills*, (1924) 139 Va. 291, 123 S.E. 542.

⁷⁵ *Dunlay v. Ave. M Garage & Repair Co.*, supra (Note 58); *People ex rel. N.Y. Trust Co. v. Graves*, (1942) 265 App. Div. 94, 37 N.Y.S.(2d) 900; *Musson v. New York & Queens Elec. Light & Power Co.*, (1931) 138 N.Y. Misc. 881, 247 N.Y. Supp. 406; *Milwaukee Sanitarium v. Swift*, supra (Note 57).

⁷⁶ Frey, "Shareholders' Preemptive Rights," 38 YALE L.J. 563.

⁷⁷ Drinker, "The Preemptive Right of Shareholders to Subscribe to New Shares," 43 HARV. L. REV. 586.

⁷⁸ *Witherbee v. Bowles*, (1911) 201 N.Y. 427, 95 N.E. 27. See also *Diamond State Brewery Inc. v. De La Rigaudiere*, (1941) 25 Del. Ch. 257, 17 A.(2d) 313.

⁷⁹ *Real Estate Trust Co. v. Bird*, (1899) 90 Md. 229, 44 A. 1048.

the closing of the corporate books by the directors a certain number of days prior to the date of allotment of preëmptive rights. Other statutes provide that the by-laws may fix a date or authorize the directors to fix a date not more than a certain number of days before the rights are to be allotted, which shall be known as the record date, after which time persons registered as stockholders will not be entitled to participate in the allotment. The object of these statutes is to determine which stockholders are entitled to preëmptive rights when shares are later issued. After the date fixed and before the time that the allotment is made, transfers of the shares cannot affect, so far as the corporation is concerned, the determination of the persons who are entitled to the rights as stockholders of record. Holders of convertible scrip or bonds or an option to purchase stock do not have preëmptive rights in the new stock.⁸⁰ Assignees of stock to which preëmptive rights are attached are entitled, of course, to exercise the rights, unless the rights have been reserved by the assignors.⁸¹ Unless the corporation has notice of the assignment, the warrant may be issued to the assignor as a stockholder of record. It has been held that as between pledgor and pledgee of stock, the pledgor is entitled to exercise preëmptive rights.⁸² And as between buyer and seller of stock, the buyer is entitled to the rights offered after sale of the stock although the transfer may not be recorded on the books of the corporation.⁸³ When an increase in the authorized capital stock is made between the time a contract for the sale of stock is entered into and the time it is executed, the preëmptive right is also vested in the buyer; but the seller is not obligated to advance his own money to exercise the right, and he incurs no liability to the buyer if the right is lost because he has failed to do so.⁸⁴

Shares of corporate stock may be presently owned by stockholders

⁸⁰ *Pratt v. American Bell Tel. Co.*, (1886) 141 Mass. 225, 5 N.E. 307; *Van Slyke v. Norris*, (1924) 159 Minn. 63, 198 N.W. 409; *Wall v. Utah Copper Co.*, *supra* (Note 68); *Levy v. Sattler*, *supra* (Note 64).

⁸¹ *Schmidt v. Pritchard*, (1907) 135 Iowa 240, 112 N.W. 801; *Baltimore City Passenger Ry. Co. v. Hamblen*, (1893) 77 Md. 341, 26 A. 279.

⁸² *Murdock v. Murdock*, (1931) 304 Pa. 565, 156 A. 303.

⁸³ *Hornblower v. Austin*, (1934) 112 Pa. Super. 90, 170 A. 358.

⁸⁴ *Currie v. White*, (1871) 45 N.Y. 822. If he desires to prevent the right from becoming lost, the vendee must supply his vendor with the funds necessary to exercise it.

whose ownership is not absolute, but may be for life only. Such stockholders are called "tenants for life" of the shares, and the persons in whom the absolute ownership of the shares will be vested upon the termination of the life tenancy, are called "remaindermen" of the shares. It is generally held that the entire value of the preemptive rights attached to the shares inures to the benefit of the remaindermen.⁸⁵ This rule, however, is not strictly followed.⁸⁶

Shareholders who have not paid in full for their shares, or who are in default for nonpayment of calls, are nevertheless entitled to exercise the preemptive rights attached to their stock.⁸⁷

Time within which preemptive rights must be exercised. The time within which a stockholder must exercise his preemptive right is generally fixed in the resolution authorizing the increase of capital stock. A majority of the stockholders have a right to fix the time to suit themselves and the interests of the corporation; the only limitation upon the exercise of the prerogative is that every stockholder shall be treated alike and shall be afforded a reasonable opportunity to subscribe.⁸⁸ Thus, extension of time cannot be given to one stockholder without the consent of the others.⁸⁹ If a stockholder fails to exercise his right within the time fixed, he is deemed to have waived his right, provided that the time was reasonable.⁹⁰ If no time is fixed, the stockholder must assert his right to subscribe within a reasonable time; otherwise it is forfeited.⁹¹ What is a reasonable length of time is a question of fact.⁹²

⁸⁵ *Plainfield Trust Co. v. Bowlby*, (1930) 107 N.J. Eq. 68, 151 A. 545; *Hayes v. St. Louis Union Trust Co.*, (1927) 317 Mo. 1028, 298 S.W. 91; in re *Merrill's Estate*, (1928) 196 Wis. 351, 220 N.W. 215.

⁸⁶ *Holbrook v. Holbrook*, (1907) 74 N.H. 201, 66 A. 124.

⁸⁷ *Electric Co. v. Edison Elec. Illuminating Co.*, (1901) 200 Pa. 516, 50 A. 164; *Reese v. Bank of Montgomery County*, (1855) 31 Pa. 78.

⁸⁸ *Hoyt v. Great American Ins. Co.*, 201 App. Div. 352, 194 N.Y. Supp. 449.

⁸⁹ *Tarlow v. Archbell*, (1943) 47 N.Y.S.(2d) 3.

⁹⁰ *Noble v. Great American Ins. Co.*, (1922) 200 App. Div. 773, 194 N.Y. Supp. 60. See also *Sommer v. Armor Gas & Oil Co.*, (1911) 71 N.Y. Misc. 211, 128 N.Y. Supp. 382, in which it was held that mere failure to exercise the right within a fixed or reasonable time bars the stockholder from contesting a disposition of the stock to someone else.

⁹¹ *Crosby v. Stratton*, *supra* (Note 64); *Seaman v. Ironwood Amusement Corp.*, (1938) 283 Mich. 220, 278 N.W. 51. But see *Oppenheimer v. Wm. F. Chiniquy Co.*, (1948) 335 Ill. App. 190, 81 N.E.(2d) 260, where time for payment was not fixed.

⁹² Compare *Jones v. Morrison*, (1883) 31 Minn. 140, 16 N.W. 854, and *Hoyt v. Great American Ins. Co.*, *supra* (Note 88), for contrasting standards of corporate responsibility to shareholders in a foreign country at the time of increase in shares.

If the corporation requires the stockholder desiring to exercise his preemptive right to pay a deposit on the new stock at the time of subscribing, failure to make the payment will result in a loss of the right to subscribe,⁹³ unless the issuance of stock is a fraud or results in a breach of directors' fiduciary duties.⁹⁴

Price at which corporation must offer shares of new capital stock to old stockholders. The general rule is that the corporation is not required to offer shares of a new issue of capital stock to its stockholders, pursuant to their preemptive rights, at par, if the stock is worth more than par.⁹⁵ However, at least one court has held that although stock is worth more than par, it must be offered to the shareholders at par.⁹⁶ In any event, the corporation cannot dispose of the stock to outsiders at a price lower than that at which it was offered to the existing stockholders.⁹⁷

Waiver of preemptive rights. The stockholder in whom there is vested a right to subscribe for shares of an issue of the increased capital stock of a corporation, may waive his preemptive right,⁹⁸ either pursuant to a provision in the certificate of incorporation, or by agreement with the corporation.⁹⁹ For example, if a stockholder agrees never to acquire a majority of the shares, he waives his pre-

⁹³ *Bellows v. Porter*, supra (Note 68); *Hyman v. Velsicol*, supra (Note 68); *Maguire v. Osborne*, supra (Note 68).

⁹⁴ *Gaines v. Long Mfg. Co.*, (1951) 234 N.C. 331, 67 S.E.(2d) 350, 355 (2 opinions).

⁹⁵ *McClanahan v. Heidelberg Brewing Co.*, (1947) 303 Ky. 739, 199 S.W.(2d) 127; *Stokes v. Continental Trust Co.*, supra (Note 68).

⁹⁶ *Hammond v. Edison Illuminating Co.*, (1902) 131 Mich. 79, 90 N.W. 1040.

⁹⁷ *Stokes v. Continental Trust Co.*, supra (Note 68).

⁹⁸ A waiver obtained by fraudulently withholding pertinent facts is ineffective. *Gord v. Iowana Farms Milk Co.*, supra (Note 68).

⁹⁹ *Heller Inv. Co. v. Southern Title & Trust Co.*, (1936) 17 Cal. App. (2d) 202, 61 P.(2d) 807; *Gottlieb v. Heyden Chemical Corp.*, (1951) 32 Del. Ch. 231, 83 A.(2d) 595, rev'd on other grounds, 33 Del. Ch. 82, 90 A.(2d) 660; *Greenbaum v. Keil*, (1948) 30 Del. Ch. 425, 62 A.(2d) 441; *Elward v. Peabody Coat Co.*, (1956) 9 Ill. App. 234, 132 N.E.(2d) 549; *Public Bancorporation v. Atlantic City Wimsett Thrift Co.*, supra (Note 64); *Hoyt v. Shenango Valley Steel Co.*, (1903) 207 Pa. 208, 56 A. 422; *Milwaukee Sanitarium v. Swift*, supra (Note 57). In *Albrecht, Maguire & Co. v. General Plastics, Inc.*, supra (note 68) it was held that an amendment of the articles of incorporation that denied the preemptive right of stockholders was valid, although the amendment was not binding on a stockholder who voted against the amendment.

On the general subject, see also 6 U. CHI. L. REV. 104; 14 NOTRE DAME LAW 23; 40 MARQ. L. REV. 23.

ëmptive right if its exercise would result in his getting a controlling share of the corporation.¹⁰⁰

No waiver of the preëmptive rights attached to shares of stock is effective against a transferee of the shares who has not had notice of it.¹⁰¹ To insure receipt of the notice by the transferee, the corporation should include a statement of the waiver in the stock certificate issued to the transferee to replace the certificate held by the transferor.

Stockholders' remedies against corporation for its violation of their preëmptive rights. If the corporation violates the preëmptive rights of the stockholder by failing to recognize them, the stockholder may bring an action in equity for specific performance,¹⁰² or an action at law for damages.¹⁰³ Another possible remedy is mandamus to compel the corporation to issue the shares to which the stockholder is, by virtue of his preëmptive rights, entitled.¹⁰⁴

The courts will not award a decree for specific performance if the company has already issued the shares to a bona fide holder.¹⁰⁵ The stockholder must resort to a suit at law to recover his damages.¹⁰⁶

To exercise a remedy against the company for its failure to recognize preëmptive rights, the stockholder must show that his personal rights have been violated, and not merely that rights of other stockholders have been infringed.¹⁰⁷

¹⁰⁰ Heylandt Sales Co. v. Welding Gas Products Co., (1943) 180 Tenn. 437, 175 S.W.(2d) 557.

¹⁰¹ Real Estate Trust Co. v. Bird, *supra* (Note 79).

¹⁰² Schmidt v. Pritchard, *supra* (Note 81); Electric Co. v. Edison Elec. Illuminating Co. *supra* (Note 87); Thomas Branch & Co. v. Riverside & Dan River Cotton Mills, *supra* (Note 74).

¹⁰³ Meredith v. New Jersey Zinc & Iron Co., *supra* (Note 74); Reading Trust Co. v. Reading Iron-Works, (1890) 137 Pa. St. 282, 21 A. 169; Thomas Branch & Co. v. Riverside & Dan River Cotton Mills, *supra* (Note 74).

¹⁰⁴ This remedy was used in Hammond v. Edison Illuminating Co., *supra* (Note 96).

¹⁰⁵ Morris v. Stevens, (1897) 178 Pa. St. 563, 36 A. 151.

¹⁰⁶ Real Estate Trust Co. v. Bird, *supra* (Note 79). A demand for the shares and a tender of the price are conditions precedent to maintaining an action for damages. Bonnet v. First Nat. Bank, *supra* (Note 70). In an action for damages, the measure of damages is the difference between the amount that the stockholder would have had to pay the company for the shares, and the value of the shares at the time the company wrongfully refused to issue them. Gray v. Portland Bank, (1807) 3 Mass. 363; Reading Trust Co. v. Reading Iron-Works, *supra* (Note 103).

¹⁰⁷ Thus a common stockholder cannot complain that preferred shareholders have not been permitted to subscribe to an issue of new shares. Weidenfeld v. Northern Pac. Ry. Co., (1904) 129 F. 305.

Stockholders' rights against persons to whom shares are issued in violation of preëemptive rights. Stockholders whose preëemptive rights in a new issue of capital stock have been violated may sue to cancel the issue so long as the shares remain in the hands of persons who took them with knowledge of the circumstances under which they were sold.¹⁰⁸ Thus, if a stockholder has acquired more than his proportionate shares of a new issue in violation of other stockholders' preëemptive rights, he may be compelled to surrender his excess shares for reissue to other stockholders who have not waived, or lost, their rights.¹⁰⁹ After the shares have come into the hands of bona fide holders for value, they cannot be cancelled.¹¹⁰

¹⁰⁸ *Schmidt v. Pritchard*, supra (Note 81); *Whitaker v. Kilby*, (1907) 55 N.Y. Misc. 337, 106 N.Y. Supp. 511.

¹⁰⁹ *Barsan v. Pioneer Sav. & Loan Co.*, (1955) 163 Ohio St. 424, 127 N.E.(2d) 614.

¹¹⁰ *Morris v. Stevens*, supra (Note 105), in which it was held that where stock was issued to a stockholder without regard for the preëemptive rights of other stockholders, and where the person to whom stock was so issued sold some of the shares, the acts of the corporation were binding as to the bona fide holder; but the seller could be prevented from obtaining any advantage by his sale of the stock illegally issued to him, by being enjoined against exercising a corresponding number of votes on his old stock until the status of the new issue should be finally determined.

CHAPTER 22

LEGAL PRINCIPLES GOVERNING SECURITY TRANSFERS

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Legal Principles Governing Security Transfers

ISSUANCE OF STOCK CERTIFICATES

Necessity for issuance of stock certificates. A certificate of stock is merely the evidence of a stockholder's interest in a corporation.¹ It is not essential to establish the existence of the shares or their ownership.² A person may be a full-fledged stockholder even if no certificate is issued.³ Under modern business conditions, however, such certificates have value as transferable symbols of property, similar to negotiable instruments, and every stockholder has a right to this evidence of his title.⁴

The statutes generally provide that every stockholder shall be entitled to a certificate of stock. In addition, provision is often made in the by-laws for its issuance.

The subscription price must usually be paid in full before the certificate of stock will be issued. Where stock is part paid, the corporation generally withholds the certificate until the stock is paid in full. However, it may issue the certificate immediately, marking it "part paid," provided that the charter or statute does not prohibit the issuance of stock before full payment is received.⁵ The provision found in the constitution and statutes of many states that no corporation

¹ *Kansas, O. & G. v. Helvering*, (1941) 124 F.(2d) 460; *Mindenberg v. Carmel Film Prod.*, (1955) 132 Cal. App. (2d) 598, 282 P.(2d) 1024; *Millar v. Mountcastle*, (1954) 161 Ohio St. 409, 119 N.E.(2d) 626.

² *Curtis v. Prudential Ins. Co.*, (1932) 55 F.(2d) 97; *Mau v. Montana Pac. Oil Co.*, (1928) 16 Del. Ch. 114, 141 A. 828; *Savic v. Kramlich*, (1932) 52 Idaho 156, 12 P.(2d) 260; *Illinois-Indiana Fair Ass'n v. Phillips*, (1926) 328 Ill. 368, 159 N.E. 815; *Harlan Nat'l Bank v. Carbon Glow Coal Co.*, (1956) (Ky.) 289 S.W.(2d) 200; *Gibson v. Oswalt*, (1934) 269 Mich. 300, 257 N.W. 825; *Greenspun v. Greenspun*, (1946) (Tex. Civ. App.) 194 S.W.(2d) 134.

³ *Conover v. Hasselman*, (1928) 206 Iowa 100, 220 N.W. 42; *Burchett v. Louisa Light & Power Co.*, (1930) 235 Ky. 296, 31 S.W.(2d) 373.

⁴ *Williams v. Everett*, (1917) (Mo.) 200 S.W. 1045; *Gallatin County Farmers' Alliance v. Flannery*, (1921) 59 Mont. 534, 197 P. 996; *Southwestern Slate Co. v. Stephens*, (1909) 139 Wis. 616, 120 N.W. 408.

⁵ *California Southern Hotel Co. v. Callender*, (1892) 94 Cal. 120, 29 P. 859.

shall issue stock, except for money paid, labor done, or property actually acquired by the corporation, does not prohibit the corporation from issuing stock as part paid. The provision is considered violated only if shares are issued as fully paid when in fact they are totally or partly unpaid.⁶

Generally the board of directors, acting under authority given to it in the by-laws, determines the units in which certificates representing the shares owned by a single stockholder shall be drawn. A stockholder, however, may specify the manner in which the certificates are to be issued, provided that his demands are reasonable and there is no regulatory provision on the subject.⁷

Transferees' right to new certificate of stock. Transferees of stock are entitled to new certificates of stock upon surrender to the corporation of the old certificate.⁸ A corporation, for its own protection, should refuse to issue a new certificate without the surrender of the old one.⁹ It cannot be compelled to issue a new one until the old one is surrendered to it, except where the original certificate is lost or destroyed.¹⁰ A certificate of stock, properly issued by a corporation having power to issue stock certificates, is a declaration by the corporation, to all persons who may innocently purchase the certificate, that the person to whom it is issued is the owner of the number of shares of stock specified in the instrument.¹¹ A bona fide holder of the certificate, that is, one who has acquired the certificate in good faith, for value, properly indorsed, has a claim to recognition as a stock-

⁶ *Scully v. Automobile Finance Co.*, (1920) 12 Del. Ch. 174, 109 A. 49.

⁷ See *Schell v. Alston Mfg. Co.*, (1906) 149 F. 439, in which the court held the demand of a shareholder who owned twenty-five shares to have twenty-five certificates issued of one share each to be unreasonable.

⁸ *O'Neil v. Wolcott Mining Co.*, (1909) 174 F. 527; *Handy v. Miner*, (1926) 258 Mass. 53, 154 N.E. 557. See also *Morris v. Hussong Dyeing Mach. Co.*, (1913) 81 N.J. Eq. 256, 86 A. 1026.

⁹ *Holly Sugar Corp. v. Wilson*, (1938) 101 Colo. 511, 75 P.(2d) 149; *Suskin v. Hodges*, (1939) 216 N.C. 333, 4 S.E.(2d) 891.

¹⁰ *Knight v. Shutz*, (1943) 141 Ohio St. 267, 47 N.E.(2d) 886. See, however, *Danbom v. Danbom*, (1937) 132 Neb. 858, 273 N.W. 502, in which it was held that a court could require a corporation to issue a new certificate to a purchaser at a sheriff's sale, without surrender of the outstanding certificate. Case is discussed in 86 U. PA. L. REV. 101. Also see page 974 *infra*.

¹¹ *Manhattan Beach Co. v. Harned*, (1886) 27 F. 484.

The corporation must make sure that the person to whom it issues the certificate is the true owner. *Grcasy Brush Coal Co. v. Hays*, (1942) 292 Ky. 517, 166 S.W.(2d) 983.

holder.¹² If the corporation issues a new certificate without demanding the surrender of the old certificate, it incurs the risk of having to recognize as stockholders bona fide purchasers of both certificates. A corporation will not be protected from liability to a bona fide holder of the old certificate, if, without demanding the surrender of the old certificate, the corporation cancelled the old certificate on its books and issued a new one.¹³

Remedies for failure to issue certificate of stock. A stockholder may pursue one of the following remedies against the corporation upon its failure to issue to him a stock certificate to which he is entitled:

1. Compel the corporation to issue the certificate by a bill in equity.¹⁴
2. Compel the issuance of the certificate by mandamus proceedings.¹⁵
3. Consider the refusal as a conversion of the stock, and recover the market value of the stock at the time of the conversion.¹⁶
4. Treat the refusal as a breach of contract, and sue for damages.¹⁷

¹² *Rand v. Hercules Powder Co.*, (1927) 129 N.Y. Misc. 891, 223 N.Y. Supp. 383. Stock may be transferred to an officer or director of a corporation in the same manner as to any individual, provided that the transaction is not fraudulent or in breach of any trust. *Du Pont v. Du Pont*, (1919) 256 F. 129.

¹³ *Nowy Swiat Publishing Co. v. Misiewicz*, (1927) 246 N.Y. 58, 158 N.E. 19.

¹⁴ *First Nat'l Bank v. Pittsburgh, F. W. & C. Ry.*, (1939) 31 F. Supp. 381; *Young v. Cockman*, (1943) 182 Md. 246, 34 A.(2d) 428; *H. M. Rowe Co. v. Rowe*, (1928) 154 Md. 599, 141 A. 334; *Virginia Pub. Serv. Co. v. Steindler*, (1936) 166 Va. 686, 187 S.E. 353. This remedy is allowed only where the value of the stock cannot be readily ascertained with reasonable certainty, and where the recovery of damages would not give adequate relief. *Falk v. Dirigold Corp.*, (1928) 174 Minn. 219, 219 N.W. 82.

¹⁵ The decisions are conflicting as to whether or not mandamus is a proper proceeding to compel a transfer. Some authorities have held that mandamus will not lie. *Spangenburg v. Western Heavy Hardware & Iron Co.*, (1913) 166 Cal. 284, 135 P. 1127; *State ex rel. Cooke v. New York-Mexican Oil Co.*, (1923) 32 Del. 244, 122 A. 55; *People ex rel. Rottenberg v. Utah Gold & Copper Mines Co.*, (1909) 135 App. Div. 418, 119 N.Y. Supp. 852. Others say that mandamus is an available remedy. *In re Ballou*, (1914) 215 F. 810; *Hanna v. Chester Times*, (1933) 310 Pa. 583, 166 A. 243. The general rule seems to be that mandamus will not lie where there is an adequate remedy at law (awarding damages) or in equity (granting specific performance).

¹⁶ *Tobias v. Wolverine Mining Co.*, (1932) 52 Idaho 576, 17 P.(2d) 338; *Young v. Cockman*, *supra* (Note 14); *Prudential Petroleum Corp. v. Rauscher, Pierce & Co.*, (1955) (Tex. Civ. App.) 281 S.W.(2d) 457; *Beaumont Hotel Co. v. Caswell*, (1929) (Tex. Civ. App.) 14 S.W.(2d) 292. See also *Seymour v. Nat'l Biscuit Co.*, (1939) 107 F.(2d) 58, cert. denied 309 U.S. 665, 60 S. Ct. 590.

¹⁷ *In re Ballou*, *supra* (Note 15); *De Lamar v. Fidelity Loan & Investment Co.*, (1924) 158 Ga. 361, 123 S.E. 116.

5. Consider the contract rescinded, and recover the money paid on the subscription.¹⁸

The court will never direct the issuance of stock if the certificates already outstanding represent the total amount that the corporation is authorized to issue.¹⁹ The stockholder, in such cases, is relegated to his remedy of money damages.²⁰ In any case, before a stockholder may maintain any action for refusal to issue a certificate, he must make a demand for it.²¹

A stockholder may also have a right of action against a corporation for damages sustained because of delay in issuing a certificate,²² but the officers of the corporation are not personally liable.²³

Form and contents of certificate of stock. The form of the stock certificate is generally determined by the directors. Ordinarily stock certificates are not required to be of any particular size or style. They need not be engraved or printed to constitute valid evidence of ownership, but may be typewritten or even written with pen and ink. However, before the New York Stock Exchange or other exchanges will accept stock for trading purposes, certificates must be engraved in accordance with the requirements specified by the rules of the exchange.

The form and contents of stock certificates must comply with any requirements set forth in the charter, by-laws, and statutes. The items most frequently included in the certificate of stock are:

1. The number of the certificate.
2. The name of the registered holder.

¹⁸ *Texla Oil Co. v. Calhoun*, (1927) 36 Ga. App. 536, 137 S.E. 84; *Beaumont Hotel Co. v. Caswell*, *supra* (Note 16).

¹⁹ *Selwyn-Brown v. Superno Co.*, (1918) 181 App. Div. 420, 168 N.Y. Supp. 918. See, however, *McWilliams v. Geddes & Moss Undertaking Co.*, (1936) (La. App.) 169 So. 894, in which it was held that a corporation could cancel the shares of stock wrongfully issued.

²⁰ *Dupoyster v. First Nat'l Bank*, (1906) 29 Ky. L. 1153, 96 S.W. 830.

²¹ *Swope v. Britton Mfg. Co.*, (1922) 279 F. 560; *Teeple v. Hawkeye Gold Dredging Co.*, (1908) 137 Iowa 206, 114 N.W. 906.

²² *Rock v. Gustaveson Oil Co.*, (1922) 59 Utah 451, 204 P. 96. The measure of damages for delay is the difference between the selling price at the time delivery was due and the selling price on the market when delivery was actually made.

²³ *Radio Electronic Television Corp. v. Bartniew Distributing Corp.*, (1940) 32 F. Supp. 431; *Hulse v. Consolidated Quicksilver Mining Corp.*, (1944) 65 Idaho 768, 154 P.(2d) 149.

3. The number of shares that the certificate represents, and the class thereof.²⁴
4. The designations, preferences, and special rights of the particular class of stock, and the limitations, restrictions, and qualifications thereof.²⁵
5. The name of the corporation issuing the stock.
6. The state of incorporation.
7. The total number of authorized shares and the par value²⁶ thereof, or, if shares have no par value, a statement to that effect.
8. The date of issuance of the certificate.²⁷
9. The signatures of the officers authorized for that purpose.
10. The corporate seal.

In addition to these requirements, any provision that is not in violation of the charter, the statutes, or the contract between the corporation and its stockholders may be inserted in the certificate, and will be binding not only as to the original parties, but as to any transferee of the stock.²⁸ The following statements are generally included in the stock certificate:

1. The shares are transferable only on the corporate books.
2. The shares are fully paid and nonassessable; or, if a certificate to represent part-paid shares is issued, the total amount of consideration to be paid for the shares and the amount paid thereon are stated.
3. The corporation retains a lien upon the stock for any indebtedness of the stockholder to it.

Temporary and permanent certificates. Temporary certificates are sometimes issued where the printing of the certificates in their permanent form has been delayed. The permanent certificates are

²⁴ *Rice & Hutchins v. Triplex Shoe Co.*, (1929) 17 Del. Ch. 356, 152 A. 342.

²⁵ *Ibid.*

²⁶ It has been held that this statement is a part of the certificate even if it appears only in the margin and not in the body of the certificate. *Fish v. Gilbert*, (1900) 73 Conn. 377, 47 A. 718.

²⁷ Parol evidence is admissible to show that the date written on the certificate was not actually the date on which the certificate was issued, where there are no minutes or records to contradict the fact. *Cannon v. Farmers' Union Grain Agency* (1921) 103 Ore. 26, 202 P. 725.

²⁸ A contractual restriction on transfer of shares, not appearing on the certificate, is binding on persons having knowledge thereof. *Doss v. Yingling*, (1930) 95 Ind. App. 494, 172 N.E. 801.

generally termed “definitive” certificates, and, when ready for distribution, they are substituted for the temporary certificates. The following is a form of notice sent to the stockholders when an exchange of permanent certificates for temporary certificates is being effected.

Form 757—Notice that permanent stock certificates are ready.

To the Holders of Temporary Certificates for Common Stock of
Company:

You are hereby notified that the permanent engraved stock certificates for the Common Stock of Company are now ready for delivery at the offices of the Transfer Agent, ... Trust Company, ...
..... Street, ... City, in exchange for and upon surrender of temporary certificates. We request that you please forward promptly to the Transfer Agent your temporary certificates, to be exchanged for the permanent certificates to which you are entitled.

If the permanent certificates are to be issued in the same name in which the temporary certificates are now registered, it will not be necessary for you to indorse the temporary certificates, and there will be no expense attached to the exchange.

If a transfer is involved and the permanent certificates are to be issued in a name other than that in which the temporary certificates are registered, an indorsement of the certificates is required, together with a guaranty of the indorsement either by a New York Stock Exchange firm or by a well-known bank or trust company. Such a transfer is also subject to federal and state taxes at the rate of¢ per share. Funds to cover such taxes should accompany all certificates to be transferred. *Please note, however, that, as already stated, no indorsement and no tax are required when the permanent certificates are to be registered in the same name as that in which the temporary certificates are registered.*

Very truly yours,
..... Company

Form 758—Form of enclosure to accompany temporary certificates sent in exchange for permanent certificates.

..... Trust Company
..... Street
..... City

Gentlemen:

Pursuant to the request contained in the circular letter addressed to the holders of temporary certificate(s) for Common Stock of Company, the undersigned is sending herewith, by registered mail, for the purposes of procuring permanent certificates, the following temporary certificates:

Certificate No.	Shares
.....	
.....	
.....	

Permanent certificates should be mailed to:
 Street, ... City.

.....
 (Signature)

.....
 (No. and Street)

.....
 (City and State)

Fractional shares or part shares. Upon the declaration of a stock dividend, upon a reduction of stock, or upon an increase of stock with the granting of rights to subscribe to additional shares, a stockholder may become entitled to less than a whole share of stock. Because of the difficulty in keeping records of parts of shares, it is customary for corporations to avoid issuing them whenever possible. In the case of a stock dividend a corporation may provide for payment in cash to a stockholder who is entitled to only part of a share of stock. The trend is toward the use of a procedure that gives the stockholder the option of buying sufficient additional fractional interests to make up a full share of stock when added to the interests to which he is entitled by reason of the dividend, or to sell his fractional interests. For a discussion of the procedures followed in respect to fractional interests see page 1006.

Signing of stock certificate. The stock certificate must be signed by the duly authorized officers of the corporation. The authority to sign is generally derived from the charter, the by-laws, or the statutes. In some cases the authority is granted by special resolution of the board of directors. Where the charter, by-laws, statute, or resolution designates the officers who must sign the certificate, the certificate must comply with the requirements.²⁹

Countersignature by the transfer agent or registrar may also be required by the charter, by-laws, statute, or resolution. Regardless of any such requirement, however, if the certificate provides on its face that it must be countersigned, or if it contains a blank for the countersignature, the certificate is not validly issued until the countersignature is placed upon it.³⁰ It is the duty of the transfer agent to see that

²⁹ See *Titus v. Great Western Turnpike Road*, (1874) 61 N.Y. 237. Certificates signed by de facto officers are valid. *Sherwood v. Wallin*, (1908) 154 Cal. 735, 99 P. 191.

³⁰ *Hudson Trust Co. v. American Linseed Co.*, (1922) 232 N.Y. 350, 134 N.E. 178, rev'g 190 App. Div. 289, 180 N.Y. Supp. 17. A certificate on which the signature of the

the proper officers sign the certificate before they countersign it, as the countersignature implies that the certificate has been properly signed.³¹

The officers of the corporation do not ordinarily sign each certificate of stock separately, as it is issued. In the absence of any statutory prohibition, a quantity of blank certificates may be signed and left with the transfer agent, to be executed and countersigned as required.³² If an officer who has signed a blank certificate should die or resign before the certificate is actually issued, the certificate is not destroyed. The by-laws generally provide that the certificates bearing the signature of the deceased or resigned officer may be recognized. The use of facsimile signatures is allowed in some states.

Forged signatures on certificates of stock. A certificate bearing the forged signature of an officer of the corporation is invalid.³³ If, however, the corporation was negligent in taking precautions to prevent the forgery,³⁴ or if the forgery was committed by a transfer officer who countersigned the certificate, the corporation cannot question its validity in the hands of a bona fide holder without notice.³⁵

Where a certificate of stock on which the signature of an officer has been forged is accepted for transfer, and a new certificate properly signed is issued, the new certificate is valid in the hands of a bona fide holder.³⁶

Necessity for seal on stock certificate. Whether or not a seal is required upon a stock certificate depends upon the statute in the particular state, or upon the corporate charter or by-laws.³⁷ If required, the seal should always be affixed to the stock certificate.

transfer agent or registrar has been forged has been held to be invalid. *Ehrich v. Guaranty Trust Co.*, (1921) 194 App. Div. 658, 186 N.Y. Supp. 103.

³¹ *Fifth Ave. Bank v. Forty-Second St. & Grand St. Ferry Ry.*, (1893) 137 N.Y. 231, 33 N.E. 378.

³² *Hudson Trust Co. v. American Linseed Co.*, *supra* (Note 30).

³³ *Citizens' Nat'l Bank v. Santa Rita Hotel Co.*, (1927) 22 F.(2d) 524.

³⁴ The mere fact that blank stock certificates were signed in advance of their issuance does not constitute such negligence as would render the corporation liable, where the clerk of the transfer agent with whom they were left forged the signature of the registrar. *Hudson Trust Co. v. American Linseed Co.*, *supra* (Note 30). To constitute negligence, the injury must be one which might reasonably have been anticipated. *Ehrich v. Guaranty Trust Co.*, *supra* (Note 30).

³⁵ *Fifth Ave. Bank v. Forty-Second St. & Grand St. Ferry Ry.*, *supra* (Note 31).

³⁶ *Manhattan Beach Co. v. Harned*, *supra* (Note 11).

³⁷ *Coddington v. Pensacola and Georgia R.R.*, (1881) 103 U.S. 400.

It has been held that a person who receives from the corporation a certificate of ownership, authenticated by the signatures of the proper officers, is a stockholder even if the officers have omitted to affix the corporate seal to the certificate.³⁸

TRANSFER OF STOCK

Negotiability of stock certificates. A negotiable instrument is one that may be transferred freely from one person to another. Upon transfer, it may give the transferee a better title than that held by his transferor. Stock certificates are not negotiable instruments under the common law.³⁹ However, the courts, recognizing the growing tendency for stock certificates to acquire the attributes of negotiable instruments, have given them a quasi-negotiable character.⁴⁰ Where the certificate of stock is indorsed in blank by the owner, it may pass from hand to hand just like any ordinary negotiable instrument.⁴¹ However, if the assignment is to a particular person, the certificates do not possess a quasi-negotiable character.⁴² If the owner of the stock has

³⁸ Halstead v. Dodge, (1884) 51 N.Y. Super. Ct. 169, aff'd, 103 N.Y. 636.

³⁹ Powers v. Pacific Diesel Engine Co., (1929) 206 Cal. 334, 274 P. 512; Barthelmess v. Cavalier, (1935) 2 Cal. App.(2d) 477, 38 P.(2d) 484; Penington v. Commonwealth Hotel Constr. Corp., (1931) 18 Del. Ch. 170, 156 A. 259; Bankers' Trust Co. v. Rood, (1930) 211 Iowa 289, 233 N.W. 794; National Surety Co. v. Indemnity Ins. Co., (1933) 237 App. Div. 485, 261 N.Y. Supp. 605.

Stock certificates are not negotiable instruments under either common law or Negotiable Instruments Law. Peckinpaugh v. H. W. Noble & Co. (1927) 238 Mich. 464, 213 N.W. 859.

Ordinarily a stock certificate is nonnegotiable but constitutes personal property subject to the ordinary rule of caveat emptor with regard to sale or assignment. State Trust & Sav. Bank v. Mayes, (1934) (Tex. Civ. App.) 67 S.W.(2d) 419.

⁴⁰ In re Shelley's Estate, (1927) 134 N.Y. Misc. 265, 234 N.Y. Supp. 497.

⁴¹ A bona fide pledgee for value of shares of stock, assigned in blank, who is without actual or imputed knowledge of equitable rights of others, acquires his title free from such equities. Sokoloff v. Wildwood Pier & Realty Co., (1931) 108 N.J. Eq. 362, 155 A. 125. A pledgee of stock pledged to secure an antecedent debt of the pledgor is not a bona fide purchaser for value, and takes the stock subject to any lien valid against the pledgor even if he had neither actual nor constructive notice thereof. Kellogg-Mackay Co. v. O'Neal, (1931) 39 Ohio App. 372, 177 N.E. 778. In Connolly v. People's State Bank, (1932) 260 Mich. 352, 244 N.W. 500, it was held that the pledgee of a certificate indorsed in blank by its owner, owes no duty to the owner to inquire into the title of the pledgor.

⁴² In the case of stock pledged by indorsement to a named pledgee, and pledged by the agent of pledgee for a personal loan, the second pledgee had no right to the certificate as against the original pledgor, because it was charged with notice that either the indorser or the indorsee was the owner, and hence its equity could not prevail

transferred the apparent absolute ownership to another, a bona fide purchaser, relying upon such apparent ownership, acquires good title as against the true owner, even though his vendor did not have good title.⁴³ The owner is estopped from asserting his title because he has enabled the person to whom he transferred apparent ownership to defraud the purchaser.⁴⁴ This rule is based on the principle that, where two innocent persons must suffer by the act of a third party, the person who has enabled the third party to occasion the loss must sustain it.⁴⁵ Where certificates of stock indorsed in blank are stolen before delivery, the thief cannot ordinarily pass title, even to a bona fide purchaser.⁴⁶ The true owner may compel the purchaser to return them, or, if they have been transferred on the corporate books, he may compel a retransfer of the shares.⁴⁷ The circumstances, however, may be such that the true owner is estopped from setting up his title as against the purchaser. If the owner, through his negligence, has made the theft possible, the right of a bona fide purchaser is superior to his own right.⁴⁸

Where a certificate is delivered to a pledgee, indorsed in blank, and

against the original indorser's legal title. *Howard v. National Copper Bank*, (1933) 81 Utah 493, 20 P.(2d) 610.

⁴³ See, *First Nat'l Bank v. Van Horn*, (1928) (Tex. Civ. App.), 2 S.W.(2d) 333.

Where an assignment is indorsed on the certificate in blank, and the certificate is subsequently stolen, a purchaser in good faith is protected. *Peckinpaugh v. H. W. Noble & Co.*, supra (Note 39). See *Bubbis v. Duffy & Bros., Inc.*, (1930) (Pa.) 14 D. & C. 281. An innocent pledgee for value of a stolen stock certificate indorsed in blank by its registered owner, is entitled to a stock dividend declared on stock represented by pledged certificate. *Commercial Nat'l Bank v. National Surety Co.*, (1932) 259 N.Y. 181, 181 N.E. 92.

⁴⁴ *Marx & Co. v. Mahan*, (1921) 17 Ala. App. 671, 88 So. 206. See also *Nolan v. Robertson*, (1930) 131 Kan. 333, 291 P. 750; *Ironside v. Levi*, (1932) 278 Mass. 18, 179 N.E. 226.

⁴⁵ *Brooks v. Union Nat'l Bank*, (1933) 137 Kan. 328, 20 P.(2d) 830. See *Adams v. Silver Shield Mining & Mill. Co.*, (1933) 82 Utah 586, 21 P.(2d) 886, in which the person claiming the right to the stock was not a purchaser for value.

⁴⁶ *McAtamney v. Broadway 7th Ave. & 56th St. Hotel Realty Corp.*, (1931) 18 Del. Ch. 170, 156 A. 259; *Hunt v. Drug Inc.*, (1931) 35 Del. 332, 156 A. 384, aff'd, 35 Del. 339, 168 A. 87.

The Uniform Stock Transfer Act has not changed the rule that the true owner of a stock certificate is not deprived of his title by theft, whether or not the theft is followed by a forgery upon the certificate and the later delivery by the thief to a bona fide purchaser. *National Surety Co. v. Indemnity Ins. Co.*, supra (Note 39).

⁴⁷ See *Hunt v. Drug Inc.*, supra (Note 46); *U.S. Fidelity & Guaranty Co. v. Newburger*, (1933) 263 N.Y. 16, 188 N.E. 141.

⁴⁸ *Shattuck v. American Cement Co.*, (1903) 205 Pa. 197, 54 A. 785. See also *Edgerly v. First Nat'l Bank*, (1935) 292 Mass. 181, 97 N.E. 518.

it is subsequently stolen from the pledgee and sold to a bona fide purchaser, the title, as between the true owner and the purchaser, again depends upon whether the former's negligence has made the theft possible.⁴⁹ If the theft and the subsequent fraudulent transfer are carried out by an agent or employee of the pledgee, the pledgee's liability depends upon whether or not the certificate was entrusted to the agent or employee.⁵⁰ If the indorsed certificate was so entrusted to him, the pledgee is liable for the agent's act of conversion.⁵¹ If, however, the agent merely had access to the documents, the pledgee is not liable.⁵²

Stock certificates have not been made negotiable by the Negotiable Instruments Law, for they do not contain the primary requirements of a negotiable instrument; that is, that the instrument must contain an unconditional promise to pay a sum certain in money, at a fixed or determinable future time, and that it must be payable to order or to bearer.

Negotiability of stock certificates under the Uniform Stock Transfer Act. The Uniform Stock Transfer Act, which is in force in almost all states and in Hawaii, gives certificates of stock greater negotiability than they have under the common law, although not full negotiability.⁵³ A transferee of a stock certificate containing a forged

⁴⁹ *Hall v. Wagner*, (1906) 111 App. Div. 70, 97 N.Y. Supp. 570; *State Trust & Sav. Bank v. Mayes*, (1934) (Tex. Civ. App.) 67 S.W.(2d) 419.

⁵⁰ That stockholder gave secretary, who forged name to stock, access to safe deposit box and ordered stock through secretary, did not show negligence or clothe secretary with apparent authority to indorse certificates. *Prince v. Childs Co.*, (1928) 23 F.(2d) 605.

⁵¹ *National Safe Deposit, Sav. & Trust Co. v. Hibbs*, (1912) 229 U.S. 391, 33 S. Ct. 818.

⁵² *Prince v. Childs Co.*, *supra* (Note 50); *Knox v. Eden Musee Americaine Co.*, (1896) 148 N.Y. 441, 42 N.E. 988.

⁵³ *Jackson v. Peerless Portland Cement Co.*, (1927) 238 Mich. 476, 213 N.W. 863. *Adams v. Silver Shield Mining & Mill. Co.*, *supra* (Note 45). See the statement in *United States Gypsum Co. v. Houston*, (1927) 239 Mich. 249, 214 N.W. 197, that the main purpose of the Act is to give full negotiability to certificates of stock. See also *National Surety Co. v. Indemnity Ins. Co.*, *supra* (Note 39). For examples of text writers who maintain that the Uniform Stock Transfer Act makes certificates of stock fully negotiable, see: WILLISTON, *SALES*, p. 717 (note 4); and BALLANTINE, *PRIVATE CORPORATIONS*, p. 473 (note 70). See also in *re Reilly Brock & Co.*, (1931) (Pa.) 15 D. & C. 98.

For a discussion of the effect of the Uniform Stock Transfer Act on the negotiability of certificates of stock, see 27 MICH. L. REV. 93.

Kentucky, Massachusetts and Pennsylvania have adopted the Uniform Commercial Code with similar provisions to those in the Uniform Stock Transfer Act. See Note 124, *infra*.

indorsement still takes the certificate subject to prior equities, even though he is a bona fide purchaser for value.⁵⁴ The Act does, however, extend the character of negotiability by protecting a bona fide purchaser of a stock certificate that has been properly indorsed.⁵⁵ When properly indorsed and delivered, a certificate of stock is enforceable by a bona fide purchaser, even if he has purchased it from one who has found the certificate, or from a thief. The title of the bona fide purchaser is not defeated by the fact that the indorsement was procured by fraud or that the delivery was made without authority. All that is required under the Uniform Stock Transfer Act to pass good title upon delivery of a stock certificate is a proper indorsement and a purchaser in good faith. A proper indorsement is an assignment by the person who is, according to the certificate, the owner of the shares represented thereby. A purchaser acts in good faith within the meaning of the Act if he acts honestly, even though negligently.

The Uniform Stock Transfer Act adds a further element of negotiability to certificates of stock by making the legal title to shares inseparable from the legal title to the certificate evidencing the shares. Another incident of negotiability is added by the provision of the Act which includes in its definition of "value" an antecedent or pre-existing obligation where a certificate is taken either in satisfaction thereof or as security therefor. A transferee who takes a stock certificate for an antecedent debt is deemed a holder for value.

The right to transfer stock—in general. Every stockholder has the right to transfer his stock without interference by the corporation, its officers, or its directors.⁵⁶ This privilege springs from the inherent power of a person to dispose of any property that he may own.⁵⁷ It is

⁵⁴ *National Surety Co. v. Indemnity Ins. Co.*, supra (Note 39); *Pierpoint v. Hoyt*, (1932) 260 N.Y. 26, 182 N.E. 235. In this latter case, the court recognized the right of the original owner of a certificate which had been stolen and on which the indorsement was forged, to sue for conversion a purchaser who refused to surrender the stock. See also *Coats v. Guaranty Bank & Trust Co.*, (1932) 174 La. 503, 141 So. 41.

⁵⁵ See 32 COLUM. L. REV. 894; 27 MICH. L. REV. 93.

⁵⁶ *Farmers' Loan & Trust Co. v. Chicago, P. & S.R. RR.*, (1896) 163 U.S. 31, 16 S. Ct. 917; *Bd. of Comm'rs v. Reynolds*, (1873) 44 Ind. 509. See also *Sterling Midland Co. v. Chicago-Williamsville Co.*, (1929) 336 Ill. 586, 168 N.E. 655; *Trisconi v. Winship*, (1891) 43 La. Ann. 45, 9 So. 29.

⁵⁷ *Howe v. Roberts*, (1923) 209 Ala. 80, 95 So. 344; *Hague v. DeLong*, (1937) 282 Mich. 330, 276 N.W. 467; *Gerdes v. Reynolds*, (1941) 28 N.Y.S.(2d) 622.

a continuing right, which exists from the time a person subscribes to the stock until the corporation dissolves.⁵⁸ When a stockholder disposes of his stock to an outsider, he does not need to know the character or responsibility of the buyer.⁵⁹

A stockholder can sell his stock to another stockholder. In fact, stockholders may mutually contract with each other that, whenever any of them wishes to sell stock, the other stockholders may have the exclusive right or option to purchase it during a limited time after notice of the wish to sell. Such an option agreement has been held binding and enforceable by several courts.⁶⁰ Such agreements are generally enforceable even if the stockholder is a majority holder. In the matter of stock transference, majority holders, whether one or a group, do not have a fiduciary relationship with other stockholders, merely by virtue of ownership of stock.⁶¹ Nevertheless, the right to alienate a majority of stock is subject to limitations. A majority stockholder cannot, in the course of selling his stock, legally dominate, interfere with, or mislead other stockholders.⁶² Nor can majority stockholders legally sell their holdings to persons who intend to loot the treasury or mismanage the corporation.⁶³ If the majority of hold-

⁵⁸ Shares cannot be transferred after dissolution, but a stockholder may assign his right to share in the assets of the corporation, subject to any claims the corporation has against the transferor. *James v. Woodruff*, (1844) 10 Paige (N.Y.) 541, *aff'd* 2 Denio (N.Y.) 574.

Shares of stock in an insolvent corporation in the process of liquidation may be transferred. The transfer carries with it whatever rights would accrue to the original owner. *Hollingsworth v. Multa Trina Ditch Co.*, (1931) 51 F.(2d) 649; *People v. California Safe Deposit & Trust Co.*, (1912) 18 Cal. App. 732, 124 P. 558; *Curtis v. Beckett*, (1943) 114 Ind. App. 221, 50 N.E.(2d) 290.

⁵⁹ *Curtis v. Beckett*, *supra* (Note 58); *Levy v. American Beverage Corp.*, (1942) 265 App. Div. 208, 38 N.Y.S.(2d) 517; *Gerdes v. Reynolds*, *supra* (Note 57).

⁶⁰ *Weissman v. Lincoln Corp.*, (1954) (Fla.) 76 So.(2d) 478; *Doss v. Yingling*, *supra* (Note 28); *Weiland v. Hogan*, (1913) 177 Mich. 626, 143 N.W. 599; *Model Clothing House v. Dickinson*, (1920) 146 Minn. 367, 178 N.W. 957; *Krieger v. Mazlish*, (1955) 145 N.Y.S.(2d) 815; *Moses v. Sould*, (1909) 63 N.Y. Misc. 203, 118 N.Y. Supp. 410, *aff'd*, 136 App. Div. 904, 120 N.Y. Supp. 1136; *Nicholson v. Franklin Brewing Co.*, (1910) 82 Ohio 94, 91 N.E. 991; *Coleman v. Kettering*, (1956) (Tex. Civ. App.) 289 S.W.(2d) 953. See *Hardin v. Rosenthal*, (1957) (Ga.) 98 S.E.(2d) 901, for an agreement held unenforceable as too indefinite in price and payment terms.

⁶¹ *Levy v. American Beverage Corp.*, *supra* (Note 59); *Gerdes v. Reynolds*, *supra* (Note 57); *Stickels*, "Stockholders' Duty in Sale of Stock," 31 B.U.L. Rev. 191.

⁶² *Roby v. Dunnett*, (1937) 88 F.(2d) 68, cert. denied, 301 U.S. 706; 13 FLETCHER, CORPORATIONS, §5805.

⁶³ *Gerdes v. Reynolds*, *supra* (Note 57); *Insuranshares Corp. v. Northern Fiscal Corp.*, (1940) 35 F. Supp. 22, noted in 25 MINN. L. REV. 525.

ers are in a position to do so, they cannot use their power to damage the corporation or injure the interests of minority holders.⁶⁴

A stockholder-director has the same right to transfer his stock as any other stockholder, provided that the transfer is not fraudulent and that it does not result in a breach of trust.⁶⁵ The fiduciary responsibility of directors to all of the stockholders will prevent their selling a controlling interest in the corporation, to the detriment of the corporation, either knowingly or with negligent failure to investigate the possibility of such detriment.⁶⁶

Where there is no question of actual harm to the corporation, the tests applied are "good faith" and "reasonable care." If both these conditions are met, then the majority stockholders are under no greater restraint as to the transfer of their shares than are the holders of minority stock.⁶⁷

While the right to alienate property is carefully guarded by the courts, reasonable restrictions thereon have been upheld⁶⁸ in cases where they are imposed: (1) by the certificate of incorporation, the by-laws, the contract of subscription, or any other contract between the corporation and the stockholder or among the stockholders them-

⁶⁴ *Lebold v. Inland Steel Co.*, (1941) 125 F.(2d) 369, cert. denied, 316 U.S. 675, 62 S. Ct. 1045; *Kavanaugh v. Kavanaugh Knitting Co.*, (1919) 226 N.Y. 185, 123 N.E. 148; *Levy v. American Beverage Corp.*, supra (Note 59).

⁶⁵ See Polster, "Fiduciary Relationship in Sale of Controlling Stock," 54 MICH. L. REV. 399.

⁶⁶ *Perlman v. Feldman*, (1955) 219 F.(2d) 173 (Ind. law); *Soderstrom v. Kungsholm Baking Co.*, (1951) 189 F.(2d) 1008; *Benson v. Braun*, (1956) 155 N.Y.S.(2d) 622. See also *Southern Pacific Co. v. Bogert*, (1919) 250 U.S. 483, 39 S. Ct. 533. Contra: *Insurance Agency Co. v. Blossom*, (1921) (Mo. App.) 231 S.W. 636 which said that injury resulting to the corporation was no barrier to the transfer of a majority interest made in good faith.

⁶⁷ *Nelson v. Northland Life Ins. Co.*, (1936) 197 Minn. 151, 266 N.W. 857; *Smith v. Gray*, (1926) 50 Nev. 56, 250 P. 369; *Levy v. American Beverage Corp.*, supra (Note 59); *Adams v. Mid-West Chevrolet Corp.*, (1947) 198 Okla. 461, 179 P.(2d) 147; *Tryon v. Smith*, (1951) 191 Ore. 172, 229 P.(2d) 251. For excellent discussions of the entire problem, see Jennings, "Trading in Corporate Control," 41 CALIF. L. REV. 1; Leech, "Transactions in Corporate Control," 104 U. PA. L. REV. 725. See also 40 CORNELL L.Q. 786; "Controlling Stockholder Liable to Minority Stockholder for Profit from Sale of Stock," 68 HARV. L. REV. 1274; Polster, "Fiduciary Relationship in Sale of Controlling Stock Interest," 54 MICH. L. REV. 399; 40 VA. L. REV. 195.

⁶⁸ It has been held that in the absence of definite statutory limitations upon the power to impose restrictions, no restrictions, properly imposed, can be declared void unless palpably unreasonable. *Brown v. Little, Brown & Co.*, (1929) 269 Mass. 102, 168 N.E. 521. Also see *Weissman v. Lincoln Corp.*, supra (Note 60), where the statute was held to authorize any reasonable restraint on transfer or alienation of shares.

selves; (2) directly by the statute; and (3) by the corporation under power given to it by statute.

Transfer of subscriptions. A subscriber who has become a stockholder by the corporation's acceptance of his subscription has the right to transfer his subscription even before any payment has been made on the contract, whether or not a certificate has been issued to him, unless the statute, the charter, or the agreement between the subscriber and the corporation provides to the contrary.⁶⁹ The assignment, in order to be effective, must be accepted by the corporation and recorded upon its books.⁷⁰ Until such acceptance and recording, the original subscriber continues to be liable for all calls made for the unpaid subscription.⁷¹ Usually, if the transfer is made by an original subscriber who is an incorporator and signer of the articles of incorporation, immediately after the corporation has received its charter, the acceptance by the corporation of the transferee as a subscriber in place of the original subscriber, is voted upon at the meeting of the incorporators and is recorded in the minutes of the meeting. The acceptance may take place at any directors' meeting. It is not essential, however, that the acceptance of a transferee in place of the original subscriber be made by formal action of the corporation, expressed in voting or otherwise. It may be implied from the acts and the course of conduct of the corporation, and the continuing recognition of the substitution of the transferee for the original subscriber.⁷²

Right of stockholders to transfer shares before payment. Stockholders may sell or transfer their stock even though the stock has not been paid for in full. (The one restriction in such a situation is that a shareholder in an insolvent corporation, with actual or implied knowledge of the insolvency, is not permitted to sell his shares to an insolvent or irresponsible person in order to escape liability on the

⁶⁹ *Roosevelt v. Hamblin*, (1908) 199 Mass. 127, 85 N.E. 98.

⁷⁰ For effect of unrecorded transfers, see page 964 et seq., *infra*.

⁷¹ *Butts v. King*, (1924) 101 Conn. 291, 125 A. 654. See also *Webster v. Upton*, (1875) 91 U.S. 384; *Campbell v. American Alkali Co.*, (1903) 125 F. 207; *Geary, St. P. & O. R.R. v. Bradbury Estate Co.*, (1918) 179 Cal. 46, 175 P. 457; *Sigua Iron Co. v. Brown*, (1902) 171 N.Y. 488, 64 N.E. 194; "Stockholders' Liability Upon Unpaid or Watered Stock Subscriptions," 24 TENN. L. REV. 584.

⁷² *Butts v. King*, *supra* (Note 71).

stock.⁷³) Title to the stock passes to the transferee at once and is not affected by the corporation's subsequent acts of recognition or refusal of recognition respecting the transfer.⁷⁴

Contractual restrictions on transfer of stock. Provisions in the charter, by-laws, or in the stock certificates themselves, restricting the transfer of stock, may be enforced as contracts between the corporation and the stockholder.⁷⁵ Inasmuch as the right of a stockholder to alienate his property involves public policy, the stockholder is not free to contract away his privilege to any extent that he chooses. The restrictions agreed upon by the stockholder, in order to be binding, must be reasonable, and they are strictly construed.⁷⁶

Agreements restricting absolutely a sale or transfer, as distinguished from agreements merely imposing reasonable conditions precedent to transfer, will not be given effect.⁷⁷

A distinction is sometimes drawn between restrictions imposed by charter and restrictions imposed upon an unwilling minority through the by-laws. Where, a by-law restriction has been adopted by the unanimous vote of stockholders, a reasonable restriction is usually upheld, particularly where the question arises among the original stockholders.⁷⁸ Even if a restriction is void when considered strictly as a by-law, it may be enforceable as an agreement entered into between the interested parties.⁷⁹

The following contractual restrictions have been declared *valid*:

A by-law provision that all shares of stock are freely assignable,

⁷³ *Banta v. Hubbell*, (1912) 167 Mo. App. 38, 150 S.W. 1089; *FLETCHER, CORPORATIONS*, §6103, §6371.

⁷⁴ *Manchester St. Ry. v. Williams*, (1902) 71 N.H. 312, 52 A. 461; 14 C.J. §921.

⁷⁵ *Vanucci v. Pedrini*, (1932) 217 Cal. 138, 17 P.(2d) 706; *Lawson v. Household Finance Corp.*, (1929) 17 Del. Ch. 1, 147 A. 312; *New England Trust Co. v. Spaulding*, (1941) 310 Mass. 424, 38 N.E.(2d) 672; *Penthouse Properties, Inc. v. 1158 Fifth Ave.*, (1939) 256 App. Div. 685, 11 N.Y.S.(2d) 416.

⁷⁶ *In re Trilling and Montague*, (1956) 140 F. Supp. 260; *McDonald v. Farley & Loetscher Mfg. Co.*, (1939) 226 Iowa 53, 283 N.W. 261; *Guaranty Laundry Co. v. Pulliam*, (1947) 198 Okla. 667, 181 P.(2d) 1007; *Citizens State Bank v. O'Leary*, (1942) 140 Tex. 305, 167 S.W.(2d) 719; *Pelton v. Nevada Oil Co.*, (1948) (Tex. Civ. App.) 209 S.W.(2d) 645; 23 MINN. L. REV. 834. See also *Allen v. Biltmore Tissue Corp.*, (1957) 2 N.Y.(2d) 534, 141 N.E.(2d) 812.

⁷⁷ *In re Laun*, (1911) 146 Wis. 252, 131 N.W. 366.

⁷⁸ *Krauss v. Kuechler*, (1938) 300 Mass. 346, 15 N.E.(2d) 207; *Weiland v. Hogan*, (1913) 177 Mich. 626, 143 N.W. 599; *In re Laun*, *supra* (Note 77).

⁷⁹ *Palmer v. Chamberlin*, (1951) 191 F.(2d) 532; *Krauss v. Kuechler*, *supra* (Note 78); *Weiland v. Hogan*, *supra* (Note 78).

but that no owner shall sell to one who is not a stockholder without first offering the stock for sale to other stockholders.⁸⁰

A by-law provision requiring stockholders to offer their stock to other stockholders at par value plus 10 per cent before selling to others.⁸¹

A provision in the certificate of stock, or the charter, that shares will not be transferred until all debts to the corporation from the record holder are paid.⁸²

A contract between stockholders whereby they take out life insurance payable to a trust fund, so that if one dies, the stock shall be turned over to the surviving stockholders, or to the corporation, and paid for out of the insurance.⁸³

A provision in the articles of incorporation requiring new stockholders to be approved by two directors.⁸⁴

These contractual restrictions have been declared *invalid*:

A by-law giving directors the right to refuse a transfer of stock by one stockholder to another.⁸⁵

A provision in the certificate that stock may be transferred only to persons approved by the directors.⁸⁶

A by-law prohibiting the transfer of stock certificates except to the corporation.⁸⁷

An agreement that no stockholder could buy or sell any stock without the written consent of all the stockholders unless the sale was made between the stockholders themselves.⁸⁸

⁸⁰ Deardon v. Deardon, (1948) 360 Pa. 255, 61 A.(2d) 348; In re Garvin's Estate, (1939) 335 Pa. 542, 6 A.(2d) 796; Rychwalski v. Milwaukee Candy Co., (1931) 205 Wis. 193, 236 N.W. 131. See also Lewis v. H. P. Hood & Sons, Inc., (1954) 331 Mass. 670, 121 N.E.(2d) 850; "When Restrictions on the Alienation of Stock Are Valid," 34 NEB. L. REV. 717.

⁸¹ Evans v. Dennis, (1948) 203 Ga. 232, 46 S.E.(2d) 122.

⁸² Elson v. Schmidt, (1941) 140 Neb. 646, 1 N.W.(2d) 314.

⁸³ Bohnsack v. Detroit Trust Co., (1940) 292 Mich. 167, 290 N.W. 367; Welchman v. Koschwitz, (1952) 21 N.J. Super. 304, 91 A.(2d) 169; Greater N.Y. Carpet House, Inc. v. Herschmann, (1940) 258 App. Div. 649, 17 N.Y.S.(2d) 483.

⁸⁴ Mason v. Mallard Telephone Co., (1932) 213 Iowa 1076, 240 N.W. 671.

⁸⁵ Morris v. Hussong Dyeing Mach. Co., (1913) 81 N.J. Eq. 256, 86 A. 1026.

⁸⁶ Douglas v. Aurora Daily News Co., (1911) 160 Ill. App. 506.

⁸⁷ Steele v. Farmers' and Merchants' Mut. Tel. Ass'n, (1915) 95 Kan. 580, 148 P. 661; Herring v. Ruskin Co-operative Ass'n, (1899) (Tenn. Ch. App.) 52 S.W. 327.

⁸⁸ People ex rel. Malcolm v. Lake Sand Corp., (1929) 251 Ill. App. 499.

A by-law declaring invalid a sale of stock to a competitor.⁸⁹

A by-law giving the directors the power to refuse a transfer for any reason.⁹⁰

Under the Uniform Stock Transfer Act stock may be transferred without restriction unless the restriction is stated on the stock certificate.⁹¹ Thus a resolution placing restrictions on transfers which is not printed on the certificates themselves will not be enforced.⁹² Where a restrictive resolution or by-law is not printed on the certificates, the corporation is not justified in refusing to transfer on its books stock purchased in violation of the resolution, whether or not the restriction is reasonable,⁹³ and even though the transferee had notice of it.⁹⁴

Corporation's option to purchase. The most common contractual restriction is that which requires a stockholder to give the corporation a first option to purchase its stock if the stockholder desires to sell it. Such restrictions have, as a general rule, been upheld as valid restraints upon alienation⁹⁵ and not violative of public policy.⁹⁶ To be valid the restriction must give the stockholder the right to dispose of

⁸⁹ *Kretzer v. Cole Bros. Lightning Rod Co.*, (1916) 193 Mo. App. 99, 191 S.W. 1066. It was held that such a provision might have been valid had it been expressly authorized by charter.

⁹⁰ *Petre v. Bruce*, (1928) 157 Tenn. 131, 7 S.W.(2d) 43.

⁹¹ *Weissman v. Lincoln Corp.*, supra (Note 60); *Weber v. Lane*, (1946) 315 Mich. 678, 24 N.W.(2d) 418; *Costello v. Farrell*, (1951) 234 Minn. 453, 48 N.W.(2d) 557. See also "Restraints on Alienation of Stock Certificates," 8 U. FLA. L. REV. 321; "Stock Liens and Transfer Restrictions Under the Uniform Stock Transfer Act," 10 ROCKY MT. L. REV. 117; "Uniform Stock Transfer Act—Effect of Notice of Restriction on Transfer," 8 VAND. L. REV. 640.

⁹² In *Doss v. Yingling*, supra (Note 28), a restriction was held to be binding on the president of the corporation, although it was not printed on the certificate he received after adoption of the Act.

⁹³ See also *Larson v. Superior Auto Parts, Inc.*, (1956) 270 Wis. 613, 72 N.W.(2d) 316.

⁹⁴ *Age Publishing Co. v. Becker*, (1943) 110 Colo. 319, 134 P.(2d) 205.

⁹⁵ *Sorricks v. Consolidated Tel. Co.*, (1954) 340 Mich. 463, 65 N.W.(2d) 713.

⁹⁶ *Warner & Swasey Co. v. Rusterholz*, (1941) 41 F. Supp. 498; *Lawson v. Household Finance Corp.*, supra (Note 75); *McDonald v. Farley & Loetscher Co.*, supra (Note 76); *Albert E. Touchet, Inc. v. Touchet*, (1928) 264 Mass. 499, 163 N.E. 184; *Model Clothing House v. Dickinson*, (1920) 146 Minn. 367, 178 N.W. 957; *Peets v. Manhasset Civil Engineers*, (1946) 68 N.Y.S.(2d) 338; *Wright v. Iredell Tel. Co.*, (1921) 182 N.C. 308, 108 S.E. 744; *First Nat'l Bank v. Shanks*, (1947) (Ohio Com. Pleas) 73 N.E.(2d) 93; 52 HARV. L. REV. 850; 23 MINN. L. REV. 834.

⁹⁷ In *re Trilling and Montague*, supra (Note 76); *Kromer v. Koepge*, (1952) 118 F. Supp. 571, aff'd (1953) 210 F.(2d) 655; *State v. Sho-Me Power Cooperative*, (1947) 356 Mo. 832, 204 S.W.(2d) 276; *Allen v. Biltmore Tissue Corp.*, (1957) 2 N.Y.(2d) 534, 141 N.E.(2d) 812; *Wright v. Iredell Tel. Co.*, supra (Note 95).

his stock to others, should the corporation decline to purchase the stock when it is offered at the price agreed upon. Where the corporation alone has the option to purchase, the corporation must have power to hold its own stock, and, if necessary, must have a surplus available with which to purchase the stock.⁹⁷

The courts differ as to the validity of a by-law providing that stockholders must offer their stock to the corporation and other stockholders before selling it to outsiders, if the statute and the charter make no provision for the passage of such a by-law. Some courts have held a by-law passed for this purpose to be invalid, while others have held it to be valid.⁹⁸ In many cases, the courts have not considered whether or not the by-law is technically valid, but have upheld the restriction where it appeared on the stock certificate, on the ground that it became a part of the contract between the corporation and the stockholder.⁹⁹ An amendment of the by-laws to make all subsequent transfers subject to the restriction has no force unless printed on the face of the certificate.¹⁰⁰ The provisions of a consent decree supersede by-law restrictions on the transfer of stock.¹⁰¹

A sale or transfer made in violation of a valid provision giving the corporation a prior option to purchase, is void.¹⁰² But directors may waive a by-law provision requiring that the stock be offered to the corporation before sale,¹⁰³ and a majority stockholder may vote his stock to prevent the corporation from making a purchase of stock under such a by-law provision.¹⁰⁴ When the by-law requirement has not been observed over a period of years, a transfer not in compliance

⁹⁷ *O'Gara v. Maguire, Inc.*, (1919) 259 F. 935; *Grasselli Chemical Co. v. Aetna Explosives Co.*, (1918) 258 F. 66; *Mancini v. Patrizi*, (1927) 87 Cal. App. 435, 262 P. 375; *Buck v. Ross*, (1896) 68 Conn. 29, 35 A. 763; *Fitzpatrick v. McGregor*, (1909) 133 Ga. 332, 65 S.E. 859.

⁹⁸ *Invalid*: *Brinkerhoff-Farris Trust & Sav. Co. v. Home Lumber Co.*, (1893) 118 Mo. 447, 24 S.W. 129; *First Nat'l Bank v. Shanks*, *supra* (Note 95).

Valid: *Sterling Loan & Inv. Co. v. Litel*, (1924) 75 Colo. 34, 223 P. 753; *Evans v. Dennis*, (1948) 203 Ga. 232, 46 S.E.(2d) 122; *Nicholson v. Franklin Brewing Co.*, (1910) 82 Ohio St. 94, 91 N.E. 991.

⁹⁹ *New England Trust Co. v. Abbott*, (1894) 162 Mass. 148, 38 N.E. 432; *Hassel v. Pohle*, (1925) 214 App. Div. 654, 212 N.Y. Supp. 561; *First Nat'l Bank v. Shanks*, *supra* (Note 95).

¹⁰⁰ *Peets v. Manhasset Civil Engineers*, *supra* (Note 95).

¹⁰¹ *Weber v. Lane*, (1946) 315 Mich. 678, 24 N.W.(2d) 418.

¹⁰² *Hassel v. Pohle*, *supra* (Note 99).

¹⁰³ *Blabon v. Hay*, (1929) 269 Mass. 401, 169 N.E. 268.

¹⁰⁴ *Kentucky Package Store v. Checani*, (1954) 331 Mass. 125, 117 N.E.(2d) 139.

with it may be upheld on the ground that the requirement is waived.¹⁰⁵

Transfers by indebted stockholders. A corporation has no lien on its shares of stock because of any indebtedness of the stockholder, in the absence of any statute, charter, or by-law creating such lien.¹⁰⁶ Stock standing in the name of a stockholder may be impressed, however, with a lien either by statute or by contract, in favor of the corporation, for debts owing to it.¹⁰⁷ Even if such a lien is created, the stockholder has a right to assign his shares subject to the lien.¹⁰⁸ However, limitations on the power of the stockholder to transfer his stock, where he is indebted to the corporation, have been upheld as contractual restrictions, where such a provision was incorporated in the charter¹⁰⁹ or in the by-laws of the corporation.¹¹⁰ Such restrictions are also specifically provided by the statute in some states. Under the Uniform Stock Transfer Act, there can be no lien in favor of the corporation unless the right of the corporation to the lien is stated on the certificate.

If the owner of the stock transfers it to a bona fide holder who has no notice of the lien of the corporation, the latter cannot refuse to transfer the stock to the name of the transferee.¹¹¹ The courts are not in agreement as to what constitutes notice to the transferee. It has been held that the purchaser of shares is chargeable with notice of liens created under the statute or charter, but not with those arising

¹⁰⁵ *Pomeroy v. Westaway*, (1947) N.Y. Misc. 307, 70 N.Y.S.(2d) 449; *Elliott v. Lindquist*, (1947) 356 Pa. 385, 52 A.(2d) 180.

¹⁰⁶ *Central Sav. Bank v. Smith*, (1908) 43 Colo. 90, 95 P. 307; *Damron v. Denny*, (1919) 149 Ga. 280, 99 S.E. 851; *Iowa-Missouri Grain Co. v. Powers*, (1923) (Iowa) 191 N.W. 363; *Gemmell v. Davis*, (1892) 75 Md. 546, 23 A. 1032; *Boyd v. Redd*, (1897) 120 N.C. 335, 27 N.E. 35.

¹⁰⁷ *Bank of Searcy v. Merchants' Grocer Co.*, (1916) 123 Ark. 403, 185 S.W. 806; *Sproul v. Standard Plate Glass Co.*, (1902) 201 Pa. 103, 50 A. 1003; *First State Bank v. First Nat'l Bank*, (1912) (Tex. Civ. App.) 145 S.W. 691; *United Cigarette Mach. Co. v. Brown*, (1916) 119 Va. 813, 89 S.E. 850.

¹⁰⁸ *Milner v. Brewer-Monaghan Mercantile Co.*, (1916) (Tex. Civ. App.) 188 S.W. 49.

¹⁰⁹ *Gibbs v. Long Island Bank*, (1894) 83 Hun (N.Y.) 92, 31 N.Y. Supp. 406.

¹¹⁰ *Costello v. Portsmouth Brewing Co.*, (1898) 69 N.H. 405, 43 A. 640.

¹¹¹ See *Kress v. Tooker-Jordan Corp.*, (1930) 103 Cal. App. 275, 284 P. 685. Unless the corporation has waived or surrendered its lien, or estopped itself from asserting it, the lien is valid and superior to the rights of any purchaser or pledgee of the stock who has not presented his stock certificates to the corporation, and who has not had the transfer recorded on its books or new certificates issued to him, showing his ownership or lien before the indebtedness of the record holder to the corporation accrued. *Benson Lumber Co. v. Thornton*, (1932) 185 Minn. 230, 240 N.W. 651.

under the by-laws of the corporation or under the custom of dealing between the corporation and its stockholders.¹¹² Notice of the lien imposed by a by-law must appear on the face of the certificate.¹¹³ Actual knowledge of one provision of the by-laws which bears no relation to the by-law imposing the lien, does not constitute constructive notice of the by-law.¹¹⁴ But a notation on the face of the stock certificate of the existence of a lien has been held sufficient notice to a purchaser to put him on inquiry.¹¹⁵

Statutory restrictions on transfers. The legislature may, by statute, impose limitations upon the power to transfer. It may also authorize the corporation to place restrictions upon this power. The power to restrict the right of alienation must, however, be given to the corporation in express terms,¹¹⁶ and any restriction will be strictly construed.

Stockholders who become such prior to the enactment of a restricting statute are not bound by it, for the power to transfer is an existing right that cannot be subsequently impaired.¹¹⁷

Corporate regulation of transfers. Regulation by the corporation of the method of transferring stock must be distinguished from a restriction upon the power of alienation. As has already been stated, the power to restrict must be given in express terms.¹¹⁸ The power to regulate, however, may be derived from the general authority to govern the corporate affairs. The regulations must be lawful and reasonable.¹¹⁹ Among the restrictive provisions most commonly found are: that stock is transferable only on the books of the corporation;¹²⁰ that

¹¹² *Bankers' Trust Co. v. McCloy*, (1913) 109 Ark. 160, 159 S.W. 205.

¹¹³ *Bank of Culloden v. Bank of Forsyth*, (1904) 120 Ga. 575, 48 S.E. 226.

A provision on the face of the stock certificate that the stock is transferable only on the company's books in accordance with the by-laws is not sufficient notice to a transferee of the existence of a lien imposed by the by-laws. *Chandler v. Blanke Tea & Coffee Co.*, (1914) 183 Mo. App. 91, 165 S.W. 819.

¹¹⁴ *Iowa-Missouri Grain Co. v. Powers*, (1924) 198 Iowa 208, 196 N.W. 979.

¹¹⁵ *Bank of Culloden v. Bank of Forsyth*, *supra* (Note 113).

¹¹⁶ *Howe v. Roberts*, *supra* (Note 57). *Manufacturers' Trust Co. v. Bank of Yorktown*, (1935) 156 N.Y. Misc. 793, 282 N.Y. Supp. 507.

¹¹⁷ *In re W. W. Mills Co.*, (1908) 162 F. 42, 54.

¹¹⁸ *Howe v. Roberts*, *supra* (Note 57).

¹¹⁹ If regulations are unlawful or unreasonable, the transferee may compel the corporation to transfer the shares to his name and issue a certificate to him. *State ex rel. Hyland v. Superior Service Laundries, Inc.*, (1930) 158 Wash. 1, 290 P. 427.

¹²⁰ See page 963 et seq.

the books of transfer be closed for a prescribed period of time prior to annual stockholders' meetings and prior to dividend days.¹²¹

Method of transfer. Any means whereby one person is divested of ownership of stock and another person acquires such ownership is a transfer.¹²² Such a change of ownership, in the absence of any statutory or charter provision to the contrary, may be effected by any of the several modes of transfer of ordinary personal property.¹²³

The Uniform Stock Transfer Act, adopted in all states¹²⁴ and Hawaii, makes uniform the method of transferring title to stock certificates issued after the effective date of the Act. The Act provides:

Title to a certificate and to the shares represented thereby can be transferred only,

(a) By delivery of the certificate indorsed either in blank or to a specified person by the person appearing by the certificate to be the owner of the shares represented thereby; or

(b) By delivery of the certificate and a separate document containing a written assignment of the certificate or a power of attorney to sell, assign or transfer the same or the shares represented thereby, signed by the person appearing by the certificate to be the owner of the shares represented thereby. Such assignment or power of attorney may be either in blank or to a specified person.

The provisions of this section shall be applicable although the charter or articles of incorporation or code of regulations or by-laws of the corporation issuing the certificate and the certificate itself provide that the shares represented thereby shall be transferable only on the books of the corporation or shall be registered by a registrar or transferred by a transfer agent.

After execution and delivery of the instruments, they are presented to the corporation with a request to transfer, the old certificate is surrendered and cancelled, a new certificate is issued to the transferee, and the stock is registered in his name. Transfer on the books of the corporation, at the request of the record owner, takes from him all

¹²¹ See page 1156.

¹²² *Wallach v. Stein*, (1927) 103 N.J. 470, 136 A. 209.

¹²³ *Cliffs Corp. v. United States*, (1939) 103 F.(2d) 77; *Crocker v. Crocker*, (1927) 84 Cal. App. 114, 257 P. 611; *Young v. New Pedrara Onyx Co.*, (1920) 48 Cal. App. 1, 192 P. 55.

¹²⁴ The Uniform Commercial Code applies to all transfers in Pennsylvania after June 30, 1954, in Massachusetts after September 30, 1958, and in Kentucky after June 30, 1960.

right, title, and interest in the stock thus transferred, and places it beyond his control. The corporation can no longer recognize his control of the stock.¹²⁵

What law governs the transfer. Where the assignment of the certificate of stock is made in one jurisdiction, and the transaction is recorded on the corporate books in another, the question arises as to which laws will determine the validity of the transfer. The following rules have been laid down by the courts:

1. The rights, duties, and obligations of the holder of the certificate and of the corporation, and of the stockholders among themselves, are determined by the laws of the corporation's domicile.¹²⁶

2. The question of who is the owner of the certificate of stock depends upon the law of the jurisdiction in which the certificate is located at the time of transfer, and in the absence of any statute, the stock and certificates are so merged that title to the stock follows the title to the certificate.¹²⁷

Necessity for delivery. As a general principle, it may be said that delivery of the stock certificate is essential to effect a transfer.¹²⁸ However, the delivery may be constructive without any actual change of custody.¹²⁹ Actual delivery may be dispensed with where a transfer is recorded on the books of the corporation.¹³⁰ However, if the statute

¹²⁵ *Copeland v. Craig*, (1940) 193 S.C. 484, 8 S.E.(2d) 858.

¹²⁶ *Pilger v. United States Steel Corp.*, (1928) 102 N.J. Eq. 506, 141 A. 737; *Maya Corporation v. Smith*, (1940) 240 Ala. 371, 199 So. 549.

¹²⁷ *Direction der Disconto-Gesellschaft v. U.S. Steel Co.*, (1925) 267 U.S. 22, 45 S. Ct. 207; See also *Hunt v. Drug*, *supra* (Note 46).

¹²⁸ *In re Broomhall, Killoughe & Co.*, (1930) 47 F.(2d) 948; *Rowell v. Fincher*, (1925) 33 Ga. App. 506, 126 S.E. 886. See, however, *Young v. New Pedrara Onyx Co.*, *supra* (Note 123), and *Leedham v. Leedham*, (1934) 218 Iowa 767, 254 N.W. 61, in which it was held that, as between the parties, delivery is not essential to the passing of title. To the same effect, *Hoffman v. Commissioner of Internal Revenue*, (1934) 71 F.(2d) 929. In this case, sale without delivery constituted a transfer for federal income tax purposes.

Merely indorsing an assignment without delivering the certificate does not effect a gift of the stock. *Gray v. Doubikin*, (1915) 188 Mo. App. 667, 176 S.W. 514. See also *White v. White*, (1929) 229 Ky. 666, 17 S.W.(2d) 733. For federal income tax purposes a transfer of stock on the books of the company constituted a delivery of the shares, and was therefore a valid gift. *Marshall v. Commissioner*, (1932) 57 F.(2d) 633.

¹²⁹ Where stock was transferred by written assignment, but no certificate had been issued either to the record holder or to the transferee, it was held that the transfer was valid, and that delivery of a certificate of stock was not necessary. *Allen v. Williams*, (1918) 212 Ill. App. 114.

¹³⁰ *Thomas v. Thomas*, (1921) 70 Colo. 29, 197 P. 243. A gift so made cannot be retracted. *Chicago Title & Trust Co. v. Ward*, (1928) 332 Ill. 126, 163 N.E. 319.

requires delivery of the certificate, a mere transfer on the corporate books without delivery would not be sufficient.¹⁸¹

Delivery of a separate written transfer has also been held to be sufficient without the delivery of the certificate of stock itself, where the certificate was not in the possession of the transferor.¹⁸²

Necessity for assignment. In addition to delivery of the stock certificate,¹⁸³ a written assignment is generally necessary to transfer legal title to stock. It has been held, however, that if the circumstances of the delivery indicate an intent to assign, the written assignment is not necessary.¹⁸⁴ In some cases, it has been held that while mere delivery without a written assignment is insufficient to pass legal title, such delivery passes to the holder an equitable title to the stock, which may be changed into a legal title by action against the corporation and the original holder to compel a transfer on the corporate books.¹⁸⁵ The equitable assignee, however, takes only such title as his assignor had.¹⁸⁶

Delivery of an unindorsed stock certificate vests an equitable title in a pledgee, if delivery as a pledge is intended, and if no rights of creditors are involved.¹⁸⁷

If no assignment is presented, the person requesting the corpora-

¹⁸¹ Haynes v. Brown, (1907) 18 Okla. 389, 89 P. 1124. See also Witthoft v. Commercial Development & Inv. Co., (1928) 46 Idaho 313, 268 P. 31.

¹⁸² Everitt v. Farmers' & Merchants' Bank, (1908) 82 Neb. 191, 117 N.W. 401. The certificates in this case were actually in the possession of the corporation.

¹⁸³ In re Shelley's Estate, supra (Note 40). See Coats v. Guaranty Bank & Trust Co., supra (Note 54); Pattberg v. Gott, (1928) 102 N.J. Eq. 371, 140 A. 795.

Delivery of the certificate of stock without a written assignment has been held to constitute an equitable assignment of the stock. J. G. Wilson Corp. v. Cahill, (1929) 152 Va. 108, 146 S.E. 274.

See Butts v. King, supra (Note 71), with regard to the necessity for an assignment to transfer rights to subscribe.

¹⁸⁴ McGowin v. Dickson, (1913) 182 Ala. 161, 62 So. 685; Miller v. Silverman, (1928) 247 N.Y. 447, 160 N.E. 910, mod. 221 App. Div. 697, 224 N.Y. Supp. 609. A gift of stock may be made by delivery of the certificate without an assignment. In re 35% Automobile Supply Co., (1917) 247 F. 377; Cole v. Frazer, (1941) 208 Mich. 374, 299 N.W. 113.

¹⁸⁵ See Massengale v. Hodgson, (1918) 148 Ga. 97, 95 S.E. 975. See also J. G. Wilson Corp. v. Cahill, supra (Note 133).

¹⁸⁶ Boston Safe Deposit & Trust Co. v. Adams, (1916) 224 Mass. 442, 113 N.E. 277.

¹⁸⁷ Dunscombe v. Crocker-Wheeler Elec. Mfg. Co., (1931) 232 App. Div. 137, 249 N.Y. Supp. 223. A stockholder who pledges an unindorsed stock certificate with a broker, as margin security, is entitled, upon the broker's bankruptcy, to a return of the stock certificate from a bank with which it had been pledged by the broker, upon tender of the amount due the broker at the time of bankruptcy. Leonard v. Boston Five Cents Savings Bank, (1931) 278 Mass. 36, 179 N.E. 229.

tion to effect a transfer on its books must furnish some other proof of his title.¹³⁸

Form of assignment. No particular form of assignment is required as long as the instrument indicates an intent to transfer.¹³⁹ An authorization to transfer stock on the books of the corporation, given to a trustee under a deed of trust, has been held sufficient.¹⁴⁰

The assignment is generally indorsed on the stock certificate itself, although it may appear in a separate instrument, commonly called a stock power.

Execution of assignment. The assignment should be signed on the line designated for that purpose. If the signature is placed elsewhere, the transfer agent should require evidence of the fact that the owner actually intended to indorse the certificate.¹⁴¹ A typewritten or stamped signature is not acceptable,¹⁴² although a signature written in pencil is entirely satisfactory.¹⁴³ The assignment need not be dated.¹⁴⁴ If an assignment is executed in any unusual manner, an investigation should be made by the transfer agent prior to the transfer, inasmuch as it may be said that the corporation is put on notice to inquire.¹⁴⁵ Similarly, if any alteration or unusual notation appears on the assignment, an explanation should be required by the transfer agent.¹⁴⁶

It is not necessary to fill in the name of the transferee on the assignment, since an assignment in blank is recognized as a valid trans-

¹³⁸ *Berl v. Virginia Production Co.*, (1933) 19 Del. Ch. 227, 166 A. 402.

¹³⁹ *Holmes v. Holmes*, (1923) 182 Wis. 163, 196 N.W. 248.

¹⁴⁰ *Curtis v. Crossley*, (1900) 59 N.J. Eq. 358, 45 A. 905.

¹⁴¹ *Treadwell v. Clark*, (1907) 190 N.Y. 51, 82 N.E. 505.

¹⁴² See *Chester County Guaranty Trust & Safe Deposit Co. v. Securities Co.*, (1914) 165 App. Div. 329, 150 N.Y. Supp. 1010. In this case, it was held that the use of a rubber stamp to affix a signature to an assignment was so unusual that the corporation should have taken every precaution to ascertain whether it was authorized.

¹⁴³ *Meier v. Continental Nat'l Bank*, (1924) 83 Ind. App. 109, 143 N.E. 377.

¹⁴⁴ *Aspell v. Campbell*, (1901) 64 App. Div. 393, 72 N.Y. Supp. 76. See also *In re Pennsylvania R.R.'s Appeal*, (1878) 86 Pa. St. 80, for the duty of a transfer agent to make inquiry where the dating is unusual. See, however, Rule 31, page 999.

¹⁴⁵ Where indorsements were pasted on the back of a certificate, and some of them were not witnessed, the transfers were held to be so unusual as to put an intending purchaser on inquiry. *Treadwell v. Clark*, (1902) 73 App. Div. 473, 77 N.Y. Supp. 350.

¹⁴⁶ See *Citizen's Nat'l Bank v. Santa Rita Hotel Co.*, (1927) 22 F.(2d) 524. See also *Hill v. American Tel. & Tel.*, (1942) 37 N.Y.S.(2d) 957. A change in the name of the assignee may constitute a forgery. *First Nat'l Bank v. Van Horn*, (1927) (Tex. Civ. App.) 2 S.W.(2d) 333.

fer of title.¹⁴⁷ The name of the transferee may be filled in by any one to whom the certificate with the blank assignment has been delivered.¹⁴⁸ This power to fill in the blanks may be exercised by a bona fide holder of the certificate, even if it has been passed from hand to hand through successive deliveries.¹⁴⁹ Each holder has a right to fill in the blank if his interests require it, and to demand registration upon the corporate books as owner.¹⁵⁰ Until fully executed by an actual transfer of the shares, the right continues, and not even the death of the party who gave the power terminates it. When a certificate, assigned in blank, is presented to a corporation for transfer on the books, the corporation may assume that the person presenting it holds the certificate and assignment lawfully, and may transfer the stock to him.¹⁵¹ However, the circumstances may be such as to put the corporation on inquiry, as where the assignment is made to a person as trustee.¹⁵²

Genuineness of signature. To satisfy itself of the genuineness of the signature on the assignment, the corporation should do one of the following things before it transfers the stock:

1. Require the assignor to appear before the corporate officers, identify himself, and acknowledge the assignment;¹⁵³ or
2. Require the signature to be guaranteed by a person of responsibility who is familiar with the assignor's signature.

For practical reasons, the second method is generally employed. It is customary to require the signature to be guaranteed by a member

¹⁴⁷ *Patterson v. Fitzpatrick McElroy Co.*, (1927) 247 Ill. App. 81; *Pilger v. U.S. Steel Corp.*, (1928) 102 N.J. Eq. 506, 141 A. 737.

¹⁴⁸ *Direction der Disconto-Gesellschaft v. U. S. Steel Corp.*, supra (Note 127). The purchaser may fill in a name other than his own. *Johnston v. Laffin*, (1881) 103 U.S. 532. The assignment takes effect on the date it is executed, and not on the date when the blanks are filled in. *Bridgeport Bank v. N. Y. & N. H. R.R.*, (1861) 30 Conn. 231.

¹⁴⁹ *Hogg v. Eckhardt*, (1931) 343 Ill. 246, 175 N.E. 382.

¹⁵⁰ *Ibid.*

¹⁵¹ The holder of a certificate, a blank assignment thereof, and an irrevocable power of attorney to record the transfer, executed by the apparent owner of the certificate, has the right to such title as will prevent the real owner from asserting any claim to the certificate as against one who purchases the stock from the holder. *Mitchell v. Boyer*, (1914) 160 App. Div. 565, 145 N.Y. Supp. 715.

¹⁵² *West v. Tintic Standard Mining Co.*, (1928) 71 Utah 158, 263 P. 490.

¹⁵³ See *Walker v. Pennsylvania Co. for Insurance*, (1919) 263 Pa. 480, 106 A. 795. In this case, the instrument forged was a power of attorney stating that the certificates had been sold and assigned to the forger.

of a local stock exchange or by a bank or trust company. It is well to have the words "signature guaranteed" appear on the guaranty. However, this is not a prerequisite, and the guarantor may merely sign his name under the signature of the owner of the stock.¹⁵⁴ The mere witnessing of a signature is deemed to be a guaranty of its genuineness.¹⁵⁵ The guaranty of the signature of the transferor is not a warranty of the genuineness of the certificate itself or of the genuineness of the signature of the issuer.¹⁵⁶ The guaranty implies that the signature on the assignment is genuine, and that the person signing it is the individual in whose name the stock stands.¹⁵⁷ If the assignment is executed in behalf of a corporation, the guaranty is also construed to imply that the person signing the name of the corporation had authority to do so.¹⁵⁸ A guaranty of the signature on an assignment does not lose its efficacy after the first transfer. It continues in full force and effect even if the certificate is passed from hand to hand in successive transfers.¹⁵⁹

A stockholder's name, signed on the assignment of the stock certificate at the request and command of and in the presence of the stockholder, is as genuine a signature as if placed upon the assignment by the stockholder personally; the corporation cannot be held for cancelling a certificate so assigned and issuing a new certificate in the name of the new stockholder.¹⁶⁰

Liability for forged transfers. It is a fundamental principle of law that a person cannot be deprived of his property without his assent or his negligence, except by legal process.¹⁶¹ If a certificate of stock is transferred under a forged assignment, the true owner is not deprived of his title to the stock even if the certificate has passed into

¹⁵⁴ See *Jennie Clarkson Home for Children v. Missouri, K. & T. Ry.*, (1905) 182 N.Y. 47, 74 N.E. 571, where it was held that the mere witnessing of a signature on a power of attorney was a guaranty of the genuineness of the signature.

¹⁵⁵ *Ibid.*

¹⁵⁶ *Appenzellar v. McCall*, (1934) 150 N.Y. Misc. 897, 270 N.Y. Supp. 748.

¹⁵⁷ See Note 154.

¹⁵⁸ *Ibid.*

¹⁵⁹ *Bassett v. Perkins*, (1909) 65 N.Y. Misc. 103, 119 N.Y. Supp. 354.

¹⁶⁰ *Coats v. Guaranty Bank and Trust Co.*, *supra* (Note 54).

¹⁶¹ *U.S. Fidelity & Guaranty Co. v. Newburger*, *supra* (Note 47). The true owner may be estopped from setting up his title where he conferred the indicia of ownership or apparent authority to transfer upon the person who diverted the security. *Hall v. Wagner*, (1906) 111 App. Div. 70, 97 N.Y. Supp. 570. See also *Robinson v. Goldfield Merger Mines Co.*, (1922) 46 Nev. 291, 206 P. 399.

the hands of an innocent third party.¹⁶² He may recover the certificate from the transferee, or he may join the transferee in an action against the corporation to compel the recognition of his title.¹⁶³ A person who applies to the corporation for registry of a transfer on a forged assignment may not retain the stock. He merely has a claim against his transferor.

If the corporation cancels the old certificate transferred upon a forged assignment and issues a new certificate, a bona fide purchaser of the new certificate is protected.¹⁶⁴ The corporation may, therefore, be compelled to recognize the rights of bona fide holders of the new certificate, as well as the rights of the owner of the old certificate.¹⁶⁵

Persons entitled to be recognized as stockholders may either bring an action against the corporation in equity to compel the recognition of their title,¹⁶⁶ or they may sue the corporation for damages.¹⁶⁷ The corporation's liability attaches even if it has exercised care in effecting the transfer.¹⁶⁸ To protect itself against the possibility of having to recognize the claims of more than one person to the same share of stock, the corporation should always require that the signature on the assignment be guaranteed.

Corporation's right to reimbursement. Under the established principles of equity, a loss must be borne by the person through

¹⁶² *National Surety Co. v. Indemnity Ins. Co.*, supra (Note 39); *Donaghue v. Di-Giorgio Fruit Corp.*, (1928) 225 App. Div. 81, 232 N.Y. Supp. 178. Where, however, the one dealing with the apparent owner has notice of the rights of the true owner, he can acquire no better title to the stock than the apparent owner can transfer. *First Nat'l Bank v. Kerr*, (1920) (Tex. Civ. App.) 225 S.W. 1106.

¹⁶³ *State ex rel. Louisiana State Bank v. Bank of Baton Rouge*, (1910) 125 La. 138, 51 So. 95. See also *Pierpoint v. Hoyt*, (1932) 260 N.Y. 26, 182 N.E. 235, holding that a conversion of the stock certificate, whether indorsed or not, is a conversion of the stock itself; also *U.S. Fidelity & Guaranty Co. v. Newburger*, supra (Note 47). Several courts have held that conversion of an unindorsed certificate is not a conversion of the stock itself. See *Daggett v. Davis*, (1884) 53 Mich. 35, 18 N.W. 548; *Davidson v. Atmar*, (1922) (Tex. Civ. App.) 243 S.W. 662; *Pardee v. Nelson*, (1922) 59 Utah 497, 205 P. 332.

¹⁶⁴ *Rand v. Hercules Powder Co.*, (1927) 129 N.Y. Misc. 891, 223 N.Y. Supp. 383.

¹⁶⁵ See Note 162.

¹⁶⁶ *Westminster Nat'l Bank v. New England Elec. Works*, (1916) 73 N.H. 465, 62 A. 971; *Morris v. Hussong Dyeing Mach. Co.*, (1913) 81 N.Y. Eq. 256, 86 A. 1026.

¹⁶⁷ *Geyser-Marion Gold Mining Co. v. Stark*, (1901) 106 F. 558. See also *Moore v. Truitt*, (1924) 97 Okla. 288, 223 P. 708; *Fiala v. Connecticut Elec. Serv. Co.*, (1932) 114 Conn. 172, 158 A. 211; *Pierpoint v. Farnum*, (1931) 234 App. Div. 205, 254 N.Y. Supp. 758.

¹⁶⁸ *Fiala v. Connecticut Elec. Serv. Co.*, supra (Note 167). But see *Citizen's Nat'l Bank v. Santa Rita Hotel Co.*, supra (Note 146).

whose negligence it was occasioned.¹⁶⁹ Accordingly, if a corporation is held liable for a forged transfer, it may seek reimbursement from the person who guaranteed the signature on the assignment,¹⁷⁰ and from the person who presented the certificate for transfer.¹⁷¹ Even if the person who presented the certificate of stock was himself misled, he will nevertheless be liable to the corporation, on the theory that, in presenting the assignment, he warranted that he was entitled to a new certificate.¹⁷² It has been held, however, that if the corporation was negligent in not detecting the forgery, or if it knew of the unlawfulness of the transfer, the person presenting the certificate would be absolved from liability.¹⁷³

Power of attorney. The power of attorney is merely an authorization to record the transfer on the books of the corporation.¹⁷⁴ It is customary for the transferor to execute the power of attorney in blank. Any bona fide holder into whose hands the certificate of stock, accompanied by an irrevocable power of attorney, may pass, may fill in the blank power and demand that the transfer be recorded.¹⁷⁵ Demand for registration¹⁷⁶ should be made upon the officer or employee of the corporation who has apparent authority to record transfers. It has been held that application to the person in charge of the office of the corporation is sufficient, regardless of what office that person may hold.¹⁷⁷ Generally the transfer officer actually performing the details

¹⁶⁹ *Phillips v. Citizens' Nat'l Bank*, (1929) (Tex. Comm. App.), 15 S.W.(2d) 550.

¹⁷⁰ *Rosler v. General Gas & Elec. Corp.*, (1932) 142 Misc. 596, 255 N.Y. Supp. 342. See also *Prince v. Childs*, *supra* (Note 50).

¹⁷¹ *Lake Superior Corp. v. Rebre*, (1917) 65 Pa. Super. 379.

¹⁷² *Boston & Albany R.R. v. Richardson*, (1883) 135 Mass. 473.

¹⁷³ The negligence must be the proximate cause of the loss. *Phillips v. Citizens' Nat'l Bank*, *supra* (Note 169). In the absence of fraud or collusion on the part of the corporation, the latter, by transferring stock on its books, does not guarantee the vendor's title and become liable therefor to the vendee. *Nutting v. Thomason*, (1872) 46 Ga. 34.

¹⁷⁴ Theoretically, title to the stock should be transferred on the books by the holder, in the absence of any contrary regulation. *Shirley Farmers' Grain & Coal Co. v. Douglass*, (1906) 130 Ill. App. 285. It has been held that if the by-laws or a notation on the stock certificate itself prescribes who shall record the transfer, that method must be followed. *Kjellman v. Scandia Fish Co.*, (1906) 128 Ill. App. 544.

¹⁷⁵ *Morris v. Hussong Dyeing Mach. Co.*, *supra* (Note 166).

¹⁷⁶ Demand for registration is usually made by the transferee. The transferor, however, has a similar right to demand a transfer on the books to the purchaser's name, and should enforce that right in order to avoid liability for any assessments which may be made upon stockholders of record. See *Richards v. Robin*, (1916) 175 App. Div. 296, 162 N.Y. Supp. 12.

¹⁷⁷ See *Hight v. Farmers' Grain Co.*, (1919) 214 Ill. App. 195. A demand is necessary

of recording the transfer and acting as attorney in fact for the transferor fills in the blank with his own name.¹⁷⁸ If the power of attorney is filled in with the name of some person other than the transfer officer, a power of substitution is given to him to permit such person, in turn, to designate the transfer officer to record the transfer. The power of substitution is usually a clause contained in the power of attorney, itself.

Authority to transfer—in general. A corporation is the trustee for its stockholders and is bound to exercise sufficient care and vigilance to prevent them from being injured by unauthorized transfers of their stock.¹⁷⁹ It is legally liable for every unauthorized transfer, to the same extent as in the case of transfers on forged assignments.¹⁸⁰ Before recording a transfer, therefore, the corporation should make sure not only that the signature on the assignment and power of attorney is genuine, but also that the person executing these instruments had authority to do so.¹⁸¹ If the circumstances attendant upon a transfer are such as to put the corporation on inquiry, the corporation is deemed to have notice of all that an inquiry would reveal.¹⁸²

Questions concerning the authority of the transferor arise most commonly in the case of transfers by: (1) agents; (2) corporations and associations; (3) joint tenants; (4) married women; (5) pledgees; and (6) fiduciaries, such as executors, administrators, guardians, and trustees. Each of these individual classes of transferors will be considered separately.

before commencing action for refusal to transfer. A demand made upon the manager on the street in front of his office was held to be sufficient, where the stockholder had previously made a demand for transfer upon the secretary, had been refused, and had been referred to the manager. *Dooley v. Gladiator Consol. Gold Mines & Mining Co.*, (1906) 134 Iowa 468, 109 N.W. 864.

¹⁷⁸ Filling in the name is not necessary, and, in actual practice, many corporations and transfer agents leave it blank.

¹⁷⁹ *Geyser-Marion Gold Mining Co. v. Stark*, supra (Note 167). See also *Seymour v. Nat'l Biscuit Co.*, (1939) 107 F.(2d) 58, cert. denied, 309 U.S. 665, 60 S. Ct. 590; *Clark & Wilson Lumber Co. v. McAllister*, (1939) 101 F.(2d) 709; *Kentucky Util. Co. v. Skaggs*, (1943) 293 Ky. 622, 169 S.W.(2d) 808.

¹⁸⁰ See page 951. See also *Geyser-Marion Gold-Mining Co. v. Stark*, supra (Note 167); *Hunt v. Drug Inc.*, supra (Note 46). Compare 24 WASH. U.L.Q. 604.

¹⁸¹ *Aronson v. Bank of America Nat'l Trust & Sav. Ass'n*, (1941) 42 Cal. App.(2d) 710, 109 P.(2d) 1001; *Baker v. Atlantic Coast Line R.R.*, (1917) 173 N.C. 365, 92 S.E. 170.

¹⁸² *Baker v. Atlantic Coast Line R.R.*, supra (Note 181). See also *West v. American Tel. & Tel. Co.*, (1939) 108 F.(2d) 347, rev'd on other grounds, (1940) 311 U.S. 223, 61 S. Ct. 179. But see *Hiller v. American Tel. & Tel. Co.*, (1949) 324 Mass. 24, 84 N.E.(2d) 548.

Transfers by agents. The owner of stock cannot be deprived of his property through a transfer by an agent if the transfer is not within the actual or apparent scope of the agent's authority.¹⁸³ If the corporation transfers the stock on the authority of someone who wrongfully assumes that he is the owner's agent, it would nevertheless be bound to recognize the rights of the real owner.¹⁸⁴ Upon the issuance of a new certificate to replace the one invalidly transferred, the corporation would also be bound to recognize the title of a bona fide purchaser of such new certificate.¹⁸⁵ The fact that the corporation acted in good faith and without negligence would not avail as a defense.¹⁸⁶ If, however, the corporation can show that the owner conferred apparent power of disposition on the agent,¹⁸⁷ or if the transfer was subsequently ratified by the principal, the corporation would not be liable.¹⁸⁸ A transfer by an agent will not be permitted after the death of the principal, inasmuch as death generally revokes an agency.¹⁸⁹

The fact that the word "agent" is added to the name of the person to whom a certificate is issued is an indication to the corporation that the stock is held by him for another, and the corporation is bound to satisfy itself as to the authority of the agent.¹⁹⁰

¹⁸³ The agent must either have specific authority to dispose of the stock or a general agency to transact the principal's business and to dispose of his property. *Camden Fire Ins. Ass'n v. Jones*, (1891) 53 N.J.L. 189, 21 A. 458.

Authority to dispose of stock does not give the agent authority to transfer it to his own name, and the corporation may subject itself to liability if it permits such a transfer without express authority from the principal. *Tafft v. Presidio & F. R.R.*, (1890) 84 Cal. 131, 24 P. 436.

¹⁸⁴ Where stock has been transferred without authority and cancelled, the true owner need not pursue the holder of the new certificate, but may proceed directly against the corporation. *St. Rimes v. Levee Steam Cotton-Press Co.*, (1888) 127 U.S. 614, 8 S. Ct. 1335.

¹⁸⁵ *Moore v. Citizens' Nat'l Bank*, (1884) 111 U.S. 156, 4 S. Ct. 345. Notice to officers of the corporation is equivalent to notice to the corporation, and no subsequent change of officers requires a new notice of the facts. *Baker v. Atlantic Coast Line R.R.*, *supra* (Note 181).

¹⁸⁶ See *A. Engelhard & Sons Co. v. MacKenzie*, (1924) 266 U.S. 131, 45 S. Ct. 68.

¹⁸⁷ *Brittan v. Oakland Bank of Sav.*, (1899) 124 Cal. 282, 57 P. 84. Even if the agent has exceeded his authority, the transferor will be bound by the agent's act in making the transfer. *First Nat'l Bank v. Van Horn*, *supra* (Note 146).

¹⁸⁸ *Dover v. Pittsburg Oil Co.*, (1904) 143 Cal. 501, 77 P. 405.

¹⁸⁹ Death revokes an agency. *Tyson v. George's Creek Coal & Iron Co.*, (1911) 115 Md. 564, 81 A. 41. If, however, the agency is coupled with an interest, it is not revoked by death. *Hunt v. Rousmanier's Administrators*, (1823) 21 U.S. 589; *Knapp v. Alvord*, (1843) 10 Paige (N.Y.) 205.

¹⁹⁰ *Tyson v. George's Creek Coal & Iron Co.*, *supra* (Note 189).

Transfers by corporations and associations. A corporation desiring to transfer stock can act only through its duly authorized officers and agents. Their authority is derived either from the charter, from the by-laws, or from a resolution of the board of directors. The transfer officer, before effecting a transfer by a corporation, should obtain proof of such authority.

When stock is registered in the name of a corporation, it may be difficult and often impossible to transfer it quickly. It is customary, therefore, to have the stock registered in the name of an individual, generally some officer or employee of the corporation designated as nominee. Immediately upon the issuance of the stock certificate in his name, this person executes an assignment in blank. Sometimes the corporation obtains from the nominee a separate instrument, stating that he has no right, title, or interest in the certificate of stock, that it is registered in his name for the account of the true owner, and that, on request, he will deliver any instrument of transfer, conveyance, or assignment required by the corporation owning the stock.¹⁹¹ If a transfer of stock held in the name of a nominee is desired, only the usual documents for individual transfers will be required.

Transfers by associations are governed generally by the same rules as govern transfers by corporations.

Transfers by joint tenants. Joint tenancies, that is, tenancies in which the interest of one tenant passes upon his death to the surviving tenant, are not generally favored.¹⁹² If personal property is held by two or more persons, it is generally presumed that their interests are not joint, but that they hold such property as tenants in common; that is, that upon the death of one tenant, his interest passes not to the surviving tenant but to those who are entitled to the deceased tenant's property. The power to create joint interests, however, has been recognized,¹⁹³ and where stock is so held, all of the joint tenants

¹⁹¹ This practice is also followed where stock is held by a fiduciary, but it has been criticized as dangerous to the trust, in *City Bank Farmers Trust Co. v. Burton*, N.Y.S. Ct., Oct. 4, 1932, N.Y.L.J., Oct. 6, 1932.

¹⁹² *Appeal of Garland*, (1927) 126 Me. 84, 136 A. 459, cert. denied, 47 S. Ct. 769; *In re Wilkins' Will*, (1928) 131 N.Y. Misc. 188, 226 N.Y. Supp. 415.

¹⁹³ *Burns v. Nolette*, (1929) 83 N.H. 489, 144 A. 848.

must join to effect a complete transfer, in the absence of any statutory provision to the contrary.¹⁹⁴

Transfers by life tenants. When stock is willed to a life tenant and remaindermen, it should be registered on the corporation's books in the name of "....., life tenant under the will of" The laws of the state of the testator and of the corporation's domicile affect the corporation's right to transfer the stock upon demand from the life tenant. However, the life tenant is not the owner of the shares and, therefore, cannot pass title under the Uniform Stock Transfer Act.¹⁹⁵ When a corporation has notice that a person is not entitled to a certificate indicating unlimited ownership, but only to a life tenancy certificate, it is liable to the remaindermen if it transfers the stock upon demand from the life tenant.¹⁹⁶ When a corporation issued new certificates and delivered them absolutely to the transferee, knowing that the transferor had only a life tenancy in the shares, the corporation was held liable in an action for conversion because it breached its duty to the remaindermen.¹⁹⁷ Even those statutes that make the corporation liable for transfer by a fiduciary only under certain conditions do not authorize transfer of the whole title to the stock upon demand of one who has only a life interest in it.

Transfers by married women. The common law disabilities of married women in the disposition of their property have generally been removed by the statute in the various states. However, some states still impose restrictions on the right of a married woman to transfer stock. Where a corporation has notice that shares are held by a married woman, the transfer officer should, before making the transfer, examine carefully the statutory requirements to see that they

¹⁹⁴ If one joint tenant transfers his interest, it merely converts the joint tenancy into a tenancy in common. *Burns v. Nolette*, supra (Note 193).

¹⁹⁵ *Seymour v. Nat'l Biscuit Co.*, supra (Note 179).

¹⁹⁶ *West v. American Tel. & Tel. Co.*, supra (Note 182).

¹⁹⁷ *Seymour v. Nat'l Biscuit Co.*, supra (Note 179). See 38 MICH. L. REV. 726. But see *Middendorf v. Kansas Power & Light Co.*, (1949) 166 Kan. 610, 203 P.(2d) 156, holding corporation will not be charged with knowledge of a will and executor's authority, and can permit a transfer by an executor-life tenant, where the proposed transfer is apparently in the ordinary course of business for the purpose of paying debts or legacies.

are strictly observed. Failure to do so will subject the corporation to liability.¹⁹⁸ If, however, the corporation had no notice that the stockholder was a married woman, either at the time of the transfer or before the certificate issued upon transfer reached the hands of an innocent purchaser, it has been held that the corporation would not be liable, even if statutory requirements upon a transfer by a married woman had not been followed.¹⁹⁹

Transfers by pledgees. If the transfer agent has knowledge or is charged with notice that stock presented for transfer is held in pledge, it has a right to require proof of the pledgee's authority to transfer, in order to protect the interests of the pledgor.²⁰⁰ The authority to sell may be regulated by statute or by the agreement of pledge. If such is the case, the transfer officer must also see that the transfer is made in accordance with those regulations. If the pledgee sells stock without complying with the terms of the pledge agreement, the sale constitutes a conversion.²⁰¹ If a sale is made without compliance with statutory requirements, not only is the sale invalid, but a penalty may be imposed.

In the absence of any agreement to the contrary, a pledgee has no right to sell stock registered in his name as pledgee before the debt for which the stock has been given as collateral becomes due.²⁰² However, on default in the payment of the pledgor's debt, the pledgee

¹⁹⁸ *Shear Co. v. Wilson*, (1927) (Tex. Com. App.) 292 S.W. 531, aff'g in part and rev'g in part 284 S.W. 654. Motion for additional opinion overruled, 294 S.W. 843.

Where the statute provides that the joint signature of husband and wife is necessary to transfer stock belonging to the wife, the statute is mandatory, and if they do not sign jointly, the transfer is invalid. *Austin v. Dickson*, (1928) (Tex. Civ. App.) 7 S.W. (2d) 147.

¹⁹⁹ *Bigby v. Atlanta & W. P. R.R.*, (1904) 119 Ga. 685, 46 S.E. 827. See also *Georgia Cas. Co. v. McRitchie*, (1932) 45 Ga. App. 697, 166 S.E. 49.

²⁰⁰ *Palmer v. O'Bannon Corp.*, (1925) 253 Mass. 8, 149 N.E. 112.

²⁰¹ *Baird v. Olsheski*, (1929) 102 Cal. App. 452, 283 P. 321; *Kelcher v. O. Edwin Barnes, Inc.*, (1932) 236 App. Div. 760, 259 N.Y. Supp. 398. A refusal by a broker or a receiver of a broker to deliver stock to a customer who has pledged the stock, and who has tendered payment of the amount due on the debt for which the stock was pledged, constitutes a conversion. *Hobart v. Vanden Bosch*, (1932) 256 Mich. 686, 240 N.W. 1.

Where the pledgee was liable to the pledgor in damages for the stipulated value of the pledged stock, the pledgee was entitled to a judgment directing the pledgor to indorse the stock to him upon payment of the judgment. *Rutherford Nat'l Bank v. Manniello*, (1934) 240 App. Div. 506, 271 N.Y. Supp. 69.

²⁰² See *Cushing v. Building Ass'n* (1913) 165 Cal. 731, 134 P. 324. In this case, a sale made prior to the time specified in the contract of pledge was held to be unauthorized.

may sell the stock even without express authorization.²⁰³ The sale must, in any event, be properly made.²⁰⁴ The pledgor cannot require the pledgee to sell pledged stock if the price obtainable will not satisfy the debt for which the stock is pledged, unless the pledgor makes up the difference.²⁰⁵ If, in pledging stock, the owner indorses the certificate in blank, or signs a stock power, and employs the customary method of transferring certificates, the person to whom the certificates are delivered can pass a good title by delivery or pledge. Thus, upon a repledge of the securities by the transferee, a new pledgee who receives the certificates in good faith may hold them as against the true owner, to secure his advances to his pledgor.²⁰⁶

Transfers by executors and administrators. In the absence of restriction in a will or in any statute, an executor or administrator may sell stock in the ordinary course of administration to pay debts or to distribute the proceeds to legatees.²⁰⁷ Accordingly, the corporation may ordinarily permit a transfer without looking beyond the letters testamentary or letters of administration for the authority to transfer.²⁰⁸ The corporation need not inquire whether the transfer is actually necessary for the payment of debts.²⁰⁹ Even if the executor or

²⁰³ A pledgee has the right by law, on default, to sell the property in satisfaction of the pledgor's obligation. *Easton v. German-American Bank*, (1888) 127 U.S. 532, 8 S. Ct. 1297. A bona fide pledgee of stock issued for a note in violation of the statute, is entitled upon foreclosure to have the stock transferred to its name, where the stock was not void but voidable at the suit of the state, and where transferee had no notice of defective title by failure to pay for the stock. *Bankers' Trust Co. v. Rood*, (1930) 211 Iowa 289, 233 N.W. 794.

Although the statute provides for demand by the pledgee upon the debtor for performance of the act for which the pledge is security before pledged stock can be sold, the pledgee can sell pledged stock without notice to the pledgor where the agreement of pledge specifically authorizes sale, upon the occurrence of a specified contingency, at public or private sale, with or without previous notice. *Woodfield v. Wells Fargo Bank*, (1931) 116 Cal. App. 647, 3 P.(2d) 65.

²⁰⁴ See *Brown v. Hotel Ass'n*, (1901) 63 Neb. 181, 88 N.W. 175, in which it was held that the sale must be made either by: (1) foreclosure suit and judicial sale; or (2) by giving reasonable notice to redeem, followed by a public sale. The parties may stipulate what notice must be given to the pledgor of an intended sale of stock pledged upon a default. The agreement, however, must not be fraudulent or inconsistent either with statutory requirements or public policy. *Baird v. Olsheski*, *supra* (Note 201).

²⁰⁵ *Peoples Nat'l Bank & Trust Co. v. Ginsburg*, (1931) 108 N.J.L. 415, 156 A. 491.

²⁰⁶ *Ironside v. Levi*, *supra* (Note 44).

²⁰⁷ *Cox v. First Nat'l Bank*, (1896) 119 N.C. 302, 26 S.E. 22.

²⁰⁸ *Peck v. Bank of America*, (1890) 16 R.I. 710, 19 A. 369. See also *Lohman v. Kansas City Southern Ry.*, (1930) 326 Mo. 819, 33 S.W.(2d) 112.

²⁰⁹ *Catherwood v. Guarantee Trust and Safe Deposit Co.*, (1916) 252 Pa. 466, 97 A. 703.

administrator commits a breach of trust, the corporation recording the transfer does not incur any liability unless it had knowledge of the breach of trust, or made the transfer in bad faith.²¹⁰ A transferee acquires good title, provided, of course, that he has no notice of any fraud on the part of the transferor.²¹¹ The circumstances of the transfer, however, may be such as to put the corporation and the transferee on inquiry.

If the will under which an executor derives his authority restricts his power to sell, both the corporation effecting the transfer and the transferee taking the stock are bound to observe the restriction, since they are chargeable with notice of the contents of the will.²¹² Likewise, they are chargeable with notice of any restriction imposed by statute upon the power to transfer the shares. The corporation recording the transfer subjects itself to liability for the unauthorized transfer, and the transferee taking the stock in violation of the restriction acquires no title.²¹³

The power of distribution by an executor or administrator is sometimes suspended by statute for a fixed period of time. Where transfers are made by way of distribution, the transfer agent should, before making the transfer, be sure that any such statutory period has expired.

The statutes in some states specify who has the right to act where there are several executors or administrators. In the absence of any statutory provision, it has been held that, unlike trustees, who must act together (see page 961), one executor may effectually dispose of the assets of an estate by his own act.²¹⁴

Transfers by minors and incompetents. A corporation is liable if it gives effect to a power of attorney to transfer shares executed by a person under legal disability, as an infant or an insane person.²¹⁵

²¹⁰ *Harris v. General Motors Corp.*, (1942) 263 App. Div. 261, 32 N.Y.S.(2d) 556.

²¹¹ *General Finance Corp. v. Keystone Credit Corp.*, (1931) 50 F.(2d) 872; *Bailie v. Sheldon*, (1921) 115 N.Y. Misc. 441, 189 N.Y. Supp. 749.

²¹² *Koelling v. Citizens' Bank*, (1922) (Mo. App.) 237 S.W. 176; rev'd on other grounds, 296 Mo. 636, 247 S.W. 411.

²¹³ *Weyer, Adm'r., v. The Second Nat'l Bank*, (1877) 57 Ind. 198. Not even the testator may dispense with the necessity for complying with the method of sale prescribed by law. *Koelling v. Citizens' Bank v. Warrentown*, *supra* (Note 212).

²¹⁴ *Leitch v. Wells*, (1872) 48 N.Y. 585.

²¹⁵ *Chew v. Bank of Baltimore*. (1859) 14 Md. 299.

However, if the corporation has no knowledge or notice of the infancy of the holder, it will not be liable if it permits a transfer by the infant, even if the transfer is subsequently avoided.²¹⁶ The corporation is duty-bound to register the transfer of stock standing in the name of an infant if the sale of stock by an infant is voidable, and not void, and if the infant has not avoided the sale at the time of the transfer.²¹⁷ When stock is registered in the name of an infant, the corporation should see that the transfer is made by an authorized representative having legal capacity and authority to transfer the stock.

Transfers by guardians. As in the case of trustees (see below), if stock is registered in the name of a guardian, with no indication of the interest of the ward, the stock is transferable just as though the transferor were an ordinary individual.²¹⁸ If, however, the transferee has notice, either actual or constructive, of the nature of the transferor's interest, the transferee is bound to inquire into the circumstances of the transfer.²¹⁹ Similarly, a corporation permitting an unauthorized transfer by a guardian will be liable to the ward if it has sufficient notice of facts to put it on inquiry.²²⁰

In addition to requiring proof of the guardian's authority to transfer, the corporation must see that the statutory requirements with regard to transfers of stock by guardians are met.²²¹ The corporation is charged with knowledge of these statutory provisions, and if a transfer is permitted without compliance with the statute, the corporation will be held liable for an unlawful transfer. Generally, where two or more guardians have been appointed, all must act together.²²² The statutes, however, sometimes make other provisions.

Transfers by trustees. When the corporation has no knowledge that stock is held in trust, it cannot be held liable if the transfer by a

²¹⁶ *Casey v. Kastel*, (1924) 237 N.Y. 305, 142 N.E. 671.

²¹⁷ *Casey v. Kastel*, *supra* (Note 216); *Smith v. Nashville & D. R.R.*, (1892) 91 Tenn. 221, 18 S.W. 546.

²¹⁸ Where stock is issued to a guardian with no indication that he holds it as guardian, a bona fide purchaser acquires good title thereto even though the transfer was made without authority. *Atkinson v. Atkinson*, (1864) 8 Allen (Mass.) 15.

²¹⁹ See *Atkinson v. Atkinson*, *supra* (Note 218).

²²⁰ *Webb v. Graniteville Mfg. Co.*, (1878) 11 S.C. 396.

²²¹ *In re Powlson's Guardianship* (1938) 229 Wis. 262, 282 N.W. 36.

²²² See *Sargent v. Shaver*, (1918) 69 Okla. 282, 172 P. 445, in which it was held that one guardian alone had no authority to execute a lease of property.

trustee is unauthorized, and the transfer is treated like any transfer by an individual.²²³ If, however, the corporation has actual or constructive notice that stock is held in trust, it must exercise reasonable care in recording transfers and issuing new certificates of stock, to avoid liability to the beneficiary of the trust for any unauthorized transfer.²²⁴

The trustee's authority is derived from the trust instrument, and the transfer officer must look to this instrument for evidence of the trustee's authority. The transfer may be made by way of sale or by way of distribution of the trust estate. If the transfer is made by sale, express or implied authority to sell must appear in the trust instrument,²²⁵ inasmuch as a trustee has no power to sell property of the estate in the absence of such authority.²²⁶ If the transfer is made by distribution, the trust instrument must be examined to see that the distribution is being properly made.²²⁷

The fact that stock is recorded on the corporate books in the name of a trustee, or that the certificate describes the holder as trustee, is sufficient to put the corporation upon inquiry.²²⁸ This does not mean that the corporation is under any obligation to see that the trust is properly executed.²²⁹ Its duty merely is to make sure that the trust

²²³ *Capitol Hill Undertaking Co. v. Render*, (1931) 149 Okla. 132, 299 P. 854. See *Smith v. Nashville & D. R.R.*, (1892) 91 Tenn. 221, 18 S.W. 546. The transferee will acquire a good title from the person registered on the books as the owner of the shares if he has no knowledge of the trust. *Allen v. Best*, (1926) 220 Mo. App. 1041, 279 S.W. 728.

²²⁴ *Geyser-Marion Gold-Mining Co. v. Stark*, *supra* (Note 167).

²²⁵ See *Boston Safe Deposit & Trust Co. v. Mixter*, (1888) 146 Mass. 100, 15 N.E. 141.

²²⁶ *Geyser-Marion Gold-Mining Co. v. Stark*, *supra* (Note 167).

²²⁷ The corporation may refuse to transfer the stock until some court of competent jurisdiction determines the ownership of stock held in trust and the authority to transfer. *Baltimore Trust Co. v. George's Creek Coal & Iron Co.*, (1912) 119 Md. 21, 85 A. 949.

²²⁸ *Geyser-Marion Gold-Mining Co. v. Stark*, *supra* (Note 167). See also: *First Nat'l Bank v. Pittsburgh, F. W. & C. Ry.*, (1939) 31 F. Supp. 381, citing *Bayard v. Farmers' & Mechanics' Bank*, (1866) 52 Pa. St. 232; *Klein v. Inman*, (1944) 298 Ky. 122, 182 S.W. (2d) 34.

²²⁹ *Hughes v. Drovers' & Mechanics' Nat'l Bank*, (1897) 86 Md. 418, 38 A. 936. A bona fide purchaser of stock sold in breach of trust is protected even if he has not registered the transfer on the corporate books. *Wilter v. Montgomery Gas-Light Co.*, (1890) 89 Ala. 544, 7 So. 773.

The Uniform Fiduciaries Act specifically provides that the corporation is not bound either to inquire whether the fiduciary is committing a breach of his trust in making the transfer, or to see that the fiduciary's obligation is performed. The corporation is liable only where registration of the transfer is made with actual knowledge that the

agreement either expressly or impliedly gives the trustee the right to make the requested transfer. It has been held, however, that if a corporation has a reasonable basis for the belief that the trustee intends to misapply funds, it will be liable if it permits the transfer.²³⁰

Statutes in some states specifically provide that neither the corporation nor its transfer agent or registrar is obligated to inquire whether or not a transfer is authorized under any trust. These statutes are in most cases limited in their application, and should be carefully examined to see whether the general rule with respect to transfers by trustees has been changed by the statute.

Where there is more than one trustee, all the trustees must concur in the execution of the assignment.²³¹

Recording of transfer—effect on stockholders' rights. Under the Uniform Stock Transfer Act, recording on the corporate books is not essential to effect a valid transfer of stock.²³² Many states, however, have statutes specifically authorizing corporations to make regulations governing the transfer of stock. Thus the by-laws of most corporations require the recording of transfers on the corporate books. These requirements are for the benefit and protection of the corporation²³³ so that it may know whom to deal with as stockholders, who has the right to vote,²³⁴ and who is entitled to receive dividends.²³⁵

fiduciary is committing a breach of his obligation as fiduciary in making the transfer, or with such knowledge as will render the registration of the transfer an act of bad faith.

The Uniform Fiduciaries Act has been adopted in the following jurisdictions: Alabama, Arizona, Colorado, District of Columbia, Hawaii, Idaho, Illinois, Indiana, Louisiana, Maryland, Minnesota, Nevada, New Jersey, New Mexico, North Carolina, Ohio, Pennsylvania, South Dakota, Tennessee, Utah, Wisconsin, and Wyoming. The following states have enacted somewhat similar laws: Kentucky, New York, and Washington.

²³⁰ See the opinion in *Hughes v. Drovers' & Mechanics' Nat'l Bank*, *supra* (Note 229). See also *King v. Richardson*, (1943) 136 F.(2d) 849.

²³¹ *Cooper v. Illinois Central R.R.*, (1899) 38 App. Div. 22, 57 N.Y. Supp. 925. See also *Bohlen's Estate*, (1874) 75 Pa. St. 304.

²³² *Upson v. Otis*, (1946) 155 F.(2d) 606; *Snyder Motor Co. v. Universal Credit Co.*, (1947) (Tex. Civ. App.) 199 S.W.(2d) 792.

²³³ *Bank of Commerce v. Bank of Newport*, (1894) 63 F. 898; *In re Giant Portland Cement Co.*, (1941) 26 Del. Ch. 32, 21 A.(2d) 697; *York's Ancillary Adm'r v. Bromley*, (1941) 286 Ky. 533, 151 S.W.(2d) 28; *Mortgage Land Investment Co. v. McMains*, (1927) 172 Minn. 110, 215 N.W. 192; *Chemical Nat'l Bank v. Colwell*, (1892) 132 N.Y. 250, 30 N.E. 644; *J. G. Wilson Corp. v. Cahill*, (1929) 152 Va. 108, 146 S.E. 274; *Lipscomb's Adm'r v. Condon*, (1904) 56 W. Va. 416, 49 S.E. 392.

²³⁴ See *Morrill v. Little Falls Mfg. Co.*, (1893) 53 Minn. 371, 55 N.W. 547.

²³⁵ *Townsend v. Tatnall Bank*, (1948) 76 Ga. App. 500, 46 S.E.(2d) 607; *Hale v. West*

Unrecorded transfer—effect as to corporation. As against the corporation, compliance with the recording requirement is necessary to effect a valid transfer²³⁶ and a transferee who has not registered his transfer is not entitled to the rights and privileges of a stockholder.²³⁷ Under an unrecorded transfer, the transferor, who is the stockholder of record, may be treated by the corporation as the owner of the stock, and will be liable for all the obligations arising out of such ownership until the transfer is recorded.²³⁸ Similarly, payment by the corporation on final distribution of assets to the shareholder of record, although not the actual stockholder, has been upheld.²³⁹

The corporation may, however, waive the requirements in respect to transfer of stock and may accept the purchaser as a stockholder even if the transfer has not been recorded on the corporate books.²⁴⁰ If the purchaser exercises stockholders' rights and assumes the status of a stockholder and the corporation recognizes him as such, the purchaser becomes entitled to the rights, and subject to the liabilities, of a stockholder exactly as if the stock had been transferred to him on the record with all the prescribed formalities.²⁴¹ If an irregular transfer is accepted and acquiesced in by the corporation, the corporation is bound by it.²⁴² Failure to register his stock does not bar a transferee

Porto Rico Sugar Co., (1922) 200 App. Div. 577, 193 N.Y. Supp. 555. But see *Lindner v. Utah Southern Oil Co.*, (1955) 3 Utah (2d) 302, 283 P.(2d) 605.

²³⁶ *Salt Dome Oil Corp. v. Schenck*, (1945) 28 Del. Ch. 433, 41 A.(2d) 583; *York's Ancillary Adm'r v. Bromley*, (1941) 286 Ky. 533, 151 S.W.(2d) 28; *Double O Mining Co. v. Simrak*, (1942) 61 Nev. 431, 132 P.(2d) 605.

Even if a transfer is recorded on the books, it may be shown that true ownership remains in the transferor. *Swan v. Swan's Ex'r*, (1923) 136 Va. 496, 117 S.E. 858. See also *Allen v. Hill*, (1860) 16 Cal. 113, in which it was held that a surviving partner could vote stock owned by the partnership even if the deceased partner appeared on the books as the record holder.

²³⁷ *Salt Dome Oil Corp. v. Schenck*, *supra* (Note 236).

²³⁸ *Bank of Commerce v. Bank of Newport*, *supra* (Note 233); *Ohman v. Lee*, (1921) 149 Minn. 451, 184 N.W. 41.

²³⁹ *Campbell v. Perth Amboy Mut. Loan, Homestead and Bldg. Ass'n*, (1909) 76 N.J. Eq. 347, 74 A. 144.

²⁴⁰ *Johnson v. Moore*, (1926) 31 Ariz. 137, 250 P. 995; *Mortgage Land Inv. Co. v. McMains*, *supra* (Note 233); *Chemical Nat'l Bank v. Colwell*, *supra* (Note 233); *American Nat'l Bank v. Oriental Mills*, (1891) 17 R.I. 551, 23 A. 795; *Stewart v. Walla Walla Printing & Publishing Co.*, (1889) 1 Wash. 521, 20 P. 605.

²⁴¹ *Ohman v. Lee*, *supra* (Note 238); *American Nat'l Bank v. Oriental Mills*, *supra* (Note 240). In the latter case the corporation failed to provide a transfer book upon which stockholders could make a formal transfer. It was held that this was a waiver of the requirement that such transfers had to be made on the corporate books "in person or by attorney."

²⁴² *Johnson v. Moore*, *supra* (Note 240); *Bassin v. Enoch-Pearl Co.*, (1947) 140 N.J.

from his claim to it as against an irregular transfer,²⁴³ nor does it prevent him from maintaining a stockholder's suit against the management for waste of corporate property.²⁴⁴ If the corporation unjustifiably refuses to register a transfer on its books, it is deemed to have waived the requirement and must recognize the person entitled to the transfer as the owner of the stock.²⁴⁵ At the time of refusal to transfer, the corporation must give its reasons for refusal, and any reasons not so given are waived.²⁴⁶

Although stock is registered in the name of one person, it may be shown that actual ownership is in another.²⁴⁷

Unrecorded transfer—effect as between the parties. Although recording of the transfer on the corporate books is necessary to effect a valid transfer as against the corporation, a transfer may be valid between the parties without observance of this requirement.²⁴⁸ As between the transferor and the transferee of the stock, delivery of the certificate with the assignment indorsed, passes the entire title in the shares, both legal and equitable, to the transferee, notwithstanding that by the terms of the charter or by-laws the stock is declared transferable only on the books of the corporation.²⁴⁹ The fact that the assignor is recognized as the stockholder by the corporation and that he continues to receive the dividends from the stock does not affect the validity of the transfer.²⁵⁰

An unregistered transfer is also valid as against persons standing in the place of the transferor, such as an administrator.²⁵¹ It may also be valid as between a pledgor and pledgee,²⁵² or between a donor and donee.²⁵³

Eq. 428, 54 A.(2d) 824; *Stewart v. Walla Walla Printing & Publishing Co.*, supra (Note 240).

²⁴³ *Laden v. Baader*, (1943) 134 N.J. Eq. 24, 34 A.(2d) 82.

²⁴⁴ *Rosenthal v. Burry Biscuit Co.*, (1948) 30 Del. Ch. 299, 60 A.(2d) 106.

²⁴⁵ *Bates v. United Shoe Mach. Co.*, (1914) 216 F. 140. See also *Logan v. Crissinger*, (1923) 290 F. 415.

²⁴⁶ *Hulse v. Consolidated Quicksilver Mining Corp.*, supra, (Note 23).

²⁴⁷ *Altaffer v. Anderson Auto Co.*, (1921) 77 Pa. Super. 63.

²⁴⁸ *J. G. Wilson Co. v. Cahill*, supra (Note 133); 12 *Fletcher, CORPORATIONS*, §5488; 53 *MICH. L. REV.* 620.

²⁴⁹ *Chatz v. Midco Oil Co.*, (1946) 152 F.(2d) 153; *Dunn v. Wilson & Co.*, (1943) 51 F. Supp. 655; *York's Ancillary Adm'r v. Bromley*, supra (Note 233).

²⁵⁰ *York's Ancillary Adm'r v. Bromley*, supra (Note 233).

²⁵¹ *Shires v. Allen*, (1910) 47 Colo. 440, 107 P. 1072.

²⁵² *Bank of Steamboat Springs v. Routt County Bank*, (1927) 80 Colo. 385, 252 P. 355; *Townsend v. Tatnall Bank*, (1948) 76 Ga. App. 500, 46 S.E.(2d) 607.

²⁵³ *Dulin v. Commissioner*, (1934) 70 F.(2d) 828.

Manner of recording. Stock transactions are generally recorded in a transfer record and in a stock ledger. The transfer record lists the various shares transferred from day to day from one person to another. The stock ledger contains the running account of each individual stockholder. A detailed explanation of the entries in the transfer record and the stock ledger, as well as a general outline of the methods employed in practice by corporations of varying sizes to record transfers, will be found in Chapter 24.

A corporation need not keep a special stock ledger and transfer record unless the statute or its charter requires them. In the absence of such requirement, transfers may be recorded in any book or record.²⁵⁴ Entries inserted on a subscription list,²⁵⁵ and a notation made in the stock certificate book,²⁵⁶ have been held to constitute sufficient compliance with a statute requiring the corporation to keep a record of transfers. In some states, the statute indicates what items must be entered in the stock records. Compliance with these statutory requirements is essential.

If, as is often the case, the statute requires that stock books or records shall be kept at an office within the state, the statute must be followed. A penalty is generally imposed upon the corporation and its officers for noncompliance.

Duty of corporation to record transfer. When there is nothing in the charter, the statute, or the by-laws that prevents it, the holder of a certificate of stock, duly assigned to him, has a right to have the stock transferred to his name on the corporate records.²⁵⁷ It is a right that arises from the contract between the corporation and the stockholder by which the corporation promises to make a transfer to a bona fide transferee upon demand and presentation of the certificate.

²⁵⁴ All that is necessary is that the fact of title be appropriately recorded in some suitable register or stock list, or otherwise formally entered upon its books. An account in the stock ledger has been held sufficient. *Cecil Nat'l Bank v. Watsontown Bank*, (1882) 105 U.S. 1039.

²⁵⁵ *Stewart v. Walla Walla Printing & Publishing Co.*, *supra* (Note 240).

²⁵⁶ *Bank of Commerce v. Bank of Newport*, *supra* (Note 233).

²⁵⁷ *Mutual Tel. Co., v. Jarrell*, (1927) 220 Ky. 551, 295 S.W. 865; *Green v. Forsyth Furniture Lines, Inc.*, (1929) 198 N.C. 104, 150 S.E. 713; *Bankers' Trust Co. v. Rood*, *supra* (Note 203).

Despite the restriction by a statute of transfers of stock held by stockholders indebted to the corporation, it has been held that a corporation may be required to transfer such stock to the name of the representative of a deceased stockholder, but not to the name of another. *In re Starbuck's Executrix*, (1929) 251 N.Y. 439, 167 N.E. 580.

The corporation cannot without good cause refuse to record a transfer on its books.²⁵⁸ If it does so, the transferee or the transferor may: (1) bring an action in equity to compel the corporation to register the transfer and issue a new certificate;²⁵⁹ (2) treat the failure as a breach of a contractual obligation and sue the corporation for damages;²⁶⁰ (3) treat the wrongful refusal as a conversion of the shares and recover damages therefor;²⁶¹ or (4) compel transfer by mandamus proceedings.²⁶²

It is generally held that the corporate officers or transfer agents are not liable directly to the transferee for refusal to record a transfer. They are merely responsible to the corporation for their conduct, and the corporation in turn must answer to the transferee.²⁶³

Justification for refusal to record transfer. A corporation, in order to avoid liability, must show that it has acted in good faith and must offer some justifiable reason for its refusal to record a transfer. It has been held that the mere fact that someone gives notice to the corporation that a transfer is invalid is not a sufficient basis for a refusal to transfer.²⁶⁴ The following have been held sufficient reasons for refusal:

1. Existence of a claim against the stock in favor of the corporation, which would be lost by a transfer.²⁶⁵

²⁵⁸ See *Powers v. Universal Film Mfg. Co.*, (1914) 162 App. Div. 806, 148 N.Y. Supp. 114. Where, under the laws of the state, adverse possession of personal property for four years or longer gives title by prescription, a transferee of stock who held shares for more than four years was entitled to have the stock transferred to her name on the books of the corporation, and to have a new certificate issued to her. *Woodcliff Gin Co. v. Kittles*, (1931) 173 Ga. 661, 161 S.E. 119.

²⁵⁹ *Jones v. Osage Oil & Refining Co.*, (1922) 280 F. 696.

²⁶⁰ See *Barrett v. King*, (1902) 181 Mass. 476, 63 N.E. 934; *Robertson v. Nicholes Co.*, (1931) 141 N.Y. Misc. 660, 253 N.Y. Supp. 76.

²⁶¹ *Gillies v. Robert E. Lee Mining Co.*, (1927) 78 Mont. 402, 254 P. 422. See also *Jones v. Osage Oil & Refining Co.*, supra (Note 259).

²⁶² The decisions as to whether or not mandamus is a proper proceeding to compel a transfer are conflicting. Some authorities have held that mandamus will not lie. *Spangerburg v. Western Heavy Hardware and Iron Co.*, (1913) 166 Cal. 284, 135 P. 1127; *State ex rel. Cooke v. New York-Mexican Oil Co.*, (1923) 32 Del. 244, 122 A. 55; *People ex rel. Rottenberg v. Utah Gold and Copper Mines Co.*, (1909) 135 App. Div. 418, 119 N.Y. Supp. 852. Others say that mandamus is an available remedy. *In re Ballou*, (1914) 215 F. 810; *Hanna v. Chester Times*, (1933) 310 Pa. 583, 166 A. 243. The general rule seems to be that mandamus will not lie when there is an adequate remedy at law (in damages) or in equity (by specific performance).

²⁶³ *Lacoe v. Wolfe*, (1933) 133 Cal. App. 159, 23 P.(2d) 831.

²⁶⁴ *O'Neil v. Wolcott Mining Co.*, (1909) 174 F. 527. There must be some evidence of title, interest, or lien that will at least raise a substantial doubt as to the right of a demandant to a transfer, in order to sustain a refusal to make it.

²⁶⁵ *Mundt v. Commercial Nat'l Bank*, (1909) 35 Utah 90, 99 P. 454. Even where the

2. The fact that the certificate was illegally issued.²⁶⁶
3. Failure to produce evidence of the right to the transfer.²⁶⁷
4. Failure to surrender the old certificate or to show that it has been lost, destroyed, or stolen.²⁶⁸
5. Noncompliance by the holder with the by-laws of the corporation governing transfers.²⁶⁹
6. Pending garnishment proceeding involving the stock.²⁷⁰
7. Doubt as to the transferor's mental capacity.²⁷¹
8. Conflicting claims.

Conflicting claims. The officers charged with the responsibility of deciding whether or not the transfer should be made are not expected to decide legal technicalities.²⁷² In case of conflicting claims, the corporation occupies a fiduciary relation to both claimants and is bound to exercise good faith in the determination of the claims.²⁷³ If a reasonable doubt exists as to the respective rights of the claimants, it is the privilege and the duty of the corporation to delay registration of the transfer for a reasonable length of time, until it can satisfy itself as to the rightful owner.²⁷⁴ If the true ownership cannot be determined by independent investigation, the corporation may protect itself by resorting to the courts for a settlement of the controversy.²⁷⁵ Where the opposing claimant does not establish his claim before the corporation, and no application to the courts is made either

statute gives the corporation a right to refuse transfer until a stockholder's indebtedness is paid, the corporation is not justified in refusing to transfer the stock of an indebted stockholder to his executrix in her representative capacity. In *re Starbuck's Executrix*, (1929) 251 N.Y. 439, 167 N.E. 580. A transferee may be entitled to a transfer subject to the lien, in the absence of any statute or by-law to the contrary. *Milner v. Brewer-Monaghan Mercantile Co.*, (1916) (Tex. Civ. App.) 188 S.W. 49.

²⁶⁶ *Lilley v. Sterling Oil & Refining Co.* (1921) 108 Kan. 686, 197 P. 201.

²⁶⁷ *Baxter v. Boston-Pacific Oil Co.*, (1927) 81 Cal. App. 187, 253 P. 185. A court of equity will enjoin a transfer where it appears that one in wrongful possession of stock is demanding a transfer. *Oden v. King*, (1927) 216 Ala. 504, 113 So. 609.

²⁶⁸ *Baxter v. Boston-Pacific Oil Co.*, *supra* (Note 267). *Luks v. Luks*, (1930) 106 N.J. Eq. 160, 150 A. 346.

²⁶⁹ *Kjellman v. Scandia Fish Co.*, *supra* (Note 174).

²⁷⁰ *United North & South Development Co. v. Rayner*, (1942) 124 F.(2d) 512.

²⁷¹ *Kentucky Util. Co. v. Skaggs*, (1943) *supra* (Note 179).

²⁷² *United North & South Development Co. v. Rayner*, *supra* (Note 270).

²⁷³ *Cooper v. Spring Valley Water Co.*, (1915) 171 Cal. 158, 153 P. 936.

²⁷⁴ *Spangenburg v. Nesbitt*, (1913) 22 Cal. App. 274, 134 P. 343.

²⁷⁵ See *Ramage v. Gould*, (1917) 176 Cal. 746, 169 P. 670. The corporation may institute an action for interpleader between the rival claimants and relieve itself of responsibility by depositing the stock in court.

by the corporation or by the parties themselves within a reasonable time, the corporation must register the stock in the name of the first claimant.²⁷⁶ Even if the court determines who is the owner of the stock, the corporation cannot effect the transfer while a decree is subject to review. If it should do so, and the decision should subsequently be reversed, the corporation would be liable to the true holder, as determined by the higher court.²⁷⁷

A corporation has no right to inquire into the legality of the transaction, as between the transferor and the transferee²⁷⁸ nor into the motive which induced the transfer,²⁷⁹ unless the transfer was not made in good faith.²⁸⁰ Neither is the corporation bound to interpret correctly the contracts of its shareholders. If there is a dispute, a judicial settlement may be necessary.²⁸¹

Penalties are imposed by statute on officers and agents for the following: (1) making false entries; (2) omitting material entries; (3) refusing to make entries;²⁸² and (4) neglecting to keep records.

Duty to cancel old certificate. Before a corporation transfers stock on its books, it must require either the surrender of the certificate of stock²⁸³ or proof that the certificate was lost, destroyed, or stolen.²⁸⁴ Failure to do so may subject the corporation to liability

²⁷⁶ *Spangenburg v. Nesbitt*, supra (Note 274).

²⁷⁷ See *Mackenzie v. A. Englehard & Sons Co.*, (1924) 266 U.S. 131, 45 S. Ct. 68.

²⁷⁸ *Baxter v. Boston-Pacific Oil Co.*, supra (Note 267).

Where a transfer is requested in the performance of a contract of sale whose completion is conditioned upon the transfer, the transfer must be made just as though it were requested as the result of a completed sale. *O'Neil v. Wolcott Mining Co.*, (1909) 174 F. 527. See also *Casey v. Kastel*, supra (Note 216); *Mundt v. Commercial Nat'l Bank*, supra (Note 265).

²⁷⁹ *Madison Bank v. Price*, (1909) 79 Kan. 289, 100 P. 280.

²⁸⁰ The fact that the transferee is a rival of the corporation does not justify refusal to transfer stock to him. *Mancini v. Setaro*, (1924) 69 Cal. App. 748, 232 P. 495. However, where the transferee paid no value for the stock, but acquired possession merely to enable him to perpetrate a fraud on the rights of another stockholder, the court will not compel the issuance of a new certificate. *Gould v. Head*, (1890) 41 F. 240.

²⁸¹ A corporation is not bound to interpret correctly legal relations existing between partners and to transfer stock to partner seeking it. *Baxter v. Boston-Pacific Oil Co.*, supra (Note 267).

²⁸² *Mancini v. Patrizi*, supra (Note 97).

²⁸³ *Shear Co. v. Wilson*, supra (Note 198).

²⁸⁴ *Factors' and Traders' Insurance Co. v. Marine Dry Dock and Shipyard Co.*, (1879) 31 La. Ann. 149, 151. Corporation is entitled to have supporting certificate indorsed before it is compelled to issue new certificate to alleged assignee. *Berl v. Virginia Production Co.*, supra (Note 138).

to the real owner of the certificate.²⁸⁵ This liability attaches even if the certificate of stock does not contain the usual statement that the stock is transferable on the corporate books "on surrender of the certificate."²⁸⁶ Any bona fide holder of the old certificate has a right to claim recognition as a stockholder despite the fact that a cancellation is recorded on the corporate books.²⁸⁷ He may bring an action in equity to compel the corporation to recognize his rights as a stockholder, or he may sue the corporation at law for damages.²⁸⁸ The corporation may, in addition, be bound to recognize the rights of a bona fide holder of the new certificate issued upon the transfer of the stock.²⁸⁹ Before liability can be fastened upon the corporation, however, it must appear that the new certificate has been validly issued, and that the person to whom it was issued took it for value and without notice.²⁹⁰ It must also appear that the transfer by the corporation was voluntary. If the corporation was compelled to cancel the old certificate and to issue a new one by some legal requirement or power which it could not successfully resist, it will not be held liable.²⁹¹

²⁸⁵ Corporation which, with knowledge of outstanding original certificate, issued to another a new certificate for share represented by original, was guilty of conversion. *Hunt v. Drug Inc.*, supra (Note 46). See also *Nowy Swiat Publishing Co., v. Misiewicz*, supra (Note 13).

For general discussion, see 38 MICH. I. REV. 726; 12 FLETCHER, CORPORATIONS, §5549; Christy and McLean, "The Transfer of Stock."

²⁸⁶ *Factors' and Traders' Inc. Co. v. Marine Dry Dock and Shipyard Co.*, supra (Note 284).

²⁸⁷ *Nowy Swiat Pub. Co., Inc. v. Misiewicz* supra (Note 13); *Edmund Wright-Ginsberg Co. v. Carlisle Ribbon Mills*, (1929) 105 N.J. Eq. 411, 148 A. 178, aff'd, memo dec. 108 N.J. Eq. 206, 154 A. 632. See also *Bay City Bank v. St. Louis Motor Sales Co.*, (1931) 255 Mich. 261, 238 N.W. 241.

²⁸⁸ Where the total authorized capital stock was issued and outstanding upon the issuance of the new certificate, it was held that a purchaser of the old certificate would not be recognized as a stockholder, but that he merely had a right to sue the corporation for damages. *Reynolds v. New York & E. Tel. & Tel. Co.*, (1908) 74 N.J. Eq. 221, 69 A. 528, aff'd, 75 N.J. Eq. 298, 78 A. 1135.

²⁸⁹ *Nowy Swiat Pub. Co., Inc. v. Misiewicz*, supra (Note 13).

²⁹⁰ *Bowen v. Imperial Theatres*, (1922) 13 Del. Ch. 120, 115 A. 918.

²⁹¹ See *Columbia Brewing Co. v. Miller*, (1922) 281 F. 289; *Shaw v. Goebel Brewing Co.*, (1913) 202 F. 408. But stock cannot be arbitrarily confiscated by an order of court. The holder of the outstanding certificate must be a party to the suit. A judgment ordering the cancellation of the certificate and a transfer of the stock without bringing in as parties the present owners of record, is void so far as it affects the stock. *Archuleta v. Archuleta*, (1912) 52 Col. 601, 123 P. 821. Under the Trading with the Enemy Act, the Alien Property Custodian was given the right to require the issuance of new certificates without presentation of the old certificates for cancellation. The Act is constitutional, for a non-enemy bona fide holder is given adequate protection by the Act. *Miller v. Kaliwerke Aschersleben Aktien-Gesellschaft*, (1922) 283 F. 746.

Issuance of new certificate. For a stockholder's right to a certificate, see page 925.

The name in which the stock certificate is to be issued must be sufficiently clear to identify the holder of the stock,²⁹² and must be legally proper, so that the stock may subsequently be transferred without difficulty. A certificate should never be issued in the name of a fictitious person, as such a person is not capable of transferring stock.²⁹³ The transferee must also be legally capable of holding the stock,²⁹⁴ and the capacity in which the stock is to be held should be clearly described. If a transferee is to hold the stock as executor or administrator,²⁹⁵ as guardian of an infant or an incompetent, or as agent²⁹⁶ or trustee, that fact should be noted on the stock certificate.

Stock cannot be transferred to a person without his consent. If, however, a person has purchased the stock, a certificate may be issued in his name without any further act on his part.²⁹⁷ A corporation which is advised, prior to transfer, that the transferee objects thereto, may refuse to transfer the stock and issue a new certificate.²⁹⁸

The issuance of the certificate by the corporation through its regular officers is its affirmation that the person named in the certificate is the owner of the number of shares specified in the instrument, and is a continuing affirmation to all who may innocently purchase the certificate that the stock is valid,²⁹⁹ and that the owner has capacity to transfer.³⁰⁰

²⁹² See Rule 49, page 1005.

²⁹³ See *Manhattan Beach Co. v. Harned*, supra (Note 11); *Jarvis v. Manhattan Beach Co.*, (1889) 53 Hun. 362, 6 N.Y. Supp. 703.

²⁹⁴ A married woman may hold stock in her own name. See *Christopher v. Norvell*, (1906) 201 U.S. 216, 26 S. Ct. 502.

²⁹⁵ An executor has a right to have the decedent's shares transferred to his name as executor. *London, Paris & American Bank, Ltd. v. Aronstein*, (1902) 117 F. 601. See also *In re Starbuck's Executrix*, supra (Note 257), and *Lacy v. First Trust & Deposit Co.*, (1931) 140 N.Y. Misc. 877, 252 N.Y. Supp. 213. Where a transfer that does not occur in the regular course of administration is required to be made in the individual name of an executrix, such transfer is sufficient notice to the transfer agent of some irregularity to require him to make inquiries. *Peck v. Bank of America*, (1890) 16 R.I. 710, 19 A. 369.

²⁹⁶ Ordinarily, the stock should be registered in the name of the principal, not in the name of the agent. However, if the parties agree, the stock may be registered in the name of the agent even without indicating the agency relationship.

²⁹⁷ *Ohman v. Lee*, supra (Note 238).

²⁹⁸ *Russell v. Easterbrook*, (1898) 71 Conn. 50, 40 A. 905.

²⁹⁹ *Mortgage Land Inv. Co. v. McMains*, (1927) 172 Minn. 110, 215 N.W. 192; See also *Manhattan Beach Co. v. Harned*, supra (Note 11).

³⁰⁰ *Jarvis v. Manhattan Beach Co.*, supra (Note 295).

Appointment of transfer agent and registrar. Small corporations generally do not employ transfer agents or registrars to assist them in the issuance and transfer of stock. The work is performed by the secretary or a clerk of the corporation. In large corporations with widely distributed shares, however, the volume of stock transactions is so large and complicated that a specially trained staff is necessary. Most banks and trust companies are specifically authorized by statute or by their charters to act as agents to transfer, register, sign, or countersign certificates of stocks, bonds, or other evidences of obligation. Such a bank or trust company may be appointed as transfer agent or registrar for the corporation in the manner generally employed by the corporation in designating its agents.

It is customary for the board of directors of a corporation to adopt a resolution of appointment, specifying the duties of the transfer agent or registrar, the class and number of shares for which the agency is created, and the rights of the agent with respect to the transfers. The transfer agent and registrar are generally furnished with a copy of the articles of incorporation and amendments, a copy of the by-laws, duly certified, specimen stock certificates, specimen signatures of the corporate officers authorized to sign certificates, and specimen signatures of officers who were theretofore authorized to sign or whose signatures appear on stock certificates already outstanding. Some transfer agents and registrars issue a bulletin showing their documentary requirements and other regulations governing their relations with corporations for whom they act as transfer agent and registrar. Many have form resolutions. A typical form resolution will be found in Chapter 10, page 443.

The agency may be terminated at the will of the corporation or of the transfer agent or registrar. Upon a removal of the transfer agent by the corporation, it is usual for the directors to adopt a resolution terminating the agency, and designating an officer of the corporation to whom the books and records are to be delivered.

More than one transfer agent or registrar may be appointed. If transfers are to be effected in more than one city, each city should have its own transfer agent or registrar.³⁰¹

³⁰¹ The New York Stock Exchange requires that certificates interchangeably transferable shall bear a legend reciting the right to transfer in New York and other cities.

A distinction has been drawn as to the nature of the relation of the corporation to the transfer agent and to the registrar. The transfer agent is said to be an agent for the corporation, with the right to ask the principal for instructions in doubtful cases. The registrar, on the other hand, is not an agent of the corporation that appoints it, but acts independently in the performance of its duty, which is to guard against the overissue of stock.

Duties of transfer agent and registrar. The transfer agent not only attends to the actual transfer of the stock on the corporate records and to the issuance of new certificates, but may take care of stock subscriptions, the preparation of stockholders' lists, the payment of dividends, the conversion or redemption of securities, and the mailing of stockholders' notices.³⁰² It also often acts as trustee in voting trust agreements. The registrar, on the other hand, is not responsible for any of the details of the transfer, but has the one duty of seeing that the corporation does not overissue its stock beyond the amount authorized.³⁰³ It keeps a record of each share of stock issued and each share cancelled.

➤ **WARNING** ➔ When the securities of a corporation are listed on a stock exchange or board of trade, it is wise to consult the rules of the exchange before appointing a transfer agent and registrar. It is often provided in such rules that the same corporation may not be appointed to serve in both capacities.

Liability of transfer agent and registrar. The transfer agent is the agent of the corporation employing it, and not the agent of the stockholders whose certificates it issues and transfers.³⁰⁴ The transfer agent owes no affirmative duty to a stockholder and incurs no personal liability in favor of such stockholder.³⁰⁵ It has been held that there is no direct liability of a transfer agent to the stockholder for wrongfully delaying or refusing to transfer stock.³⁰⁶ The agent

³⁰² See Page & Gates, "The Work of Corporate Trust Departments." New York: Prentice-Hall, Inc.

³⁰³ The duty of the registrar is to guard against fraudulent or unauthorized issues of stock. *Jarvis v. Manhattan Beach Co.*, supra (Note 293); Liability for fraud in issuing watered or fictitiously paid-up stock rests only on persons committing, having notice of, or participating in, the fraud. *Gray Constr. Co. v. Fantle*, (1934) 62 S.D. 345, 253 N.W. 253.

³⁰⁴ *Nicholson v. Morgan*, (1922) 119 N.Y. Misc. 309, 196 N.Y. Supp. 147.

³⁰⁵ *Palmer v. O'Bannon Corp.*, (1925) 253 Mass., 8, 149, N.E. 112.

³⁰⁶ *Mears v. Crocker First Nat'l Bank* (1950) 97 Cal. App. (2d) 482, 218 P.(2d) 91. See *Christy and McClean*, "The Transfer of Stock," (2d ed.) §268, §281.

is answerable to the corporation rather than the individual transferee for nonfeasance.³⁰⁷ The corporation, in turn, is liable to the transferee.

Primarily, the transfer agent is responsible to the corporation for the following: (1) wrongful refusals to transfer;³⁰⁸ (2) any wrongful transfers; and (3) any failure to perform duties attendant upon the agency.³⁰⁹ The transfer agent is often made answerable by statute for failure to pay taxes due on transfers, or for allowing transfers to be made before the required tax waivers have been obtained.

The registrar is liable both to the corporation and to an injured stockholder if it allows an overissue of stock.

Insurance against errors of transfer agent and registrar. While, under general legal principles, the transfer agent and registrar are responsible to the corporation for their errors, the contract executed upon their appointment generally permits them to exercise their judgment in performing their duties and absolves them from responsibility for errors. The corporation in such cases is left without recourse if liability is fastened upon it for unlawful transfers. To protect itself against losses of this nature, the corporation may enter into a contract with an insurance company. In consideration of the payment of a fixed premium, the insurance company will indemnify the corporation against losses resulting from any act or omission of the transfer agent or registrar or of any employee of the transfer agent or registrar, in respect to the issue, reissue, exchange, receipt, or payment of the corporation's securities. In accepting a policy for this purpose, the corporation should carefully examine its terms to see that the risks for which provision is to be made are adequately covered.

Lost or destroyed certificates. A stockholder may compel the corporation to issue duplicate certificates in place of those lost, destroyed, or stolen.³¹⁰ This right is now specifically provided by statute

³⁰⁷ *Fowler v. National City Bank*, (1934) 49 Ga. App. 435, 176 S.E. 113.

³⁰⁸ *Age Publishing Co. v. Becker*, supra (Note 93); *Young v. Cockman*, (1943) 182 Md. 246, 34 A.(2d) 428. See also Dewey, "The Transfer Agent's Dilemma: Conflicting Claims to Shares of Stock," 52 HARV. L. REV. 553; Van Antwerp, "Liability of Transfer Agents for Wrongful Refusal to Transfer Shares," 50 MICH. L. REV. 155.

³⁰⁹ *Nicholson v. Morgan*, supra (Note 304).

³¹⁰ *Tilton v. Iowa Oil Co.*, (1934) 139 Cal. App. 93, 33 P.(2d) 446; *Beneke v. Bankers'*

in most states. However, it existed at common law, and even in the absence of such a statute, a corporation may be compelled by a court of equity to issue duplicate certificates.³¹¹ The remedy provided by the various statutes for refusal of the corporation to issue the duplicates has been held to be in addition to the common law right.³¹²

The by-laws of the corporation generally outline the conditions upon which new certificates may be issued³¹³ without resort to the courts. Where the statute prescribes the conditions, the by-laws will follow the statutory provision. The following are generally required:

1. An order from the stockholder, directing the corporation to stop any transfer of the lost certificate.
2. An affidavit of the stockholder, indicating the facts leading to the loss of the certificate.
3. Advertisement by the stockholder of the loss of the certificate, and presentation to the corporation of proof of such advertisement.
4. An indemnity bond, approved by the directors of the corporation, in an amount double the market value of the stock at the time of the application for the new certificate.
5. The lapse of a specified period of time before the issuance of the new certificate.

The provisions of the by-laws and the statutory requirements should be followed carefully in replacing certificates.³¹⁴ If the statutory requirements have been met, the corporation must issue a

Mortgage Co., (1932) 135 Kan. 444, 10 P.(2d) 825; *La Belle Iron Works v. Quarter Sav. Bank*, (1914) 74 W. Va. 569, 82 S.E. 614.

For provisions of the Uniform Stock Transfer Act (Sec. 17) authorizing issuance, on court order, of new stock certificate in place of certificate lost or destroyed, see *Prentice-Hall Stock Transfer*.

³¹¹ *Will's Adm'r v. George Wiedemann Brewing Co.*, (1916) 171 Ky. 681, 188 S.W. 778. See *Brown v. Anderson-Cottonwood Irrigation Dist.*, (1920) 183 Cal. 186, 190 P. 797.

³¹² *Davis v. Lime Cola Bottling Works*, (1922) 18 Ala. App. 562, 93 So. 328.

³¹³ A corporation issuing new certificates to replace certificates alleged to have been, but which were not, in fact, destroyed, without complying with the requirements of the Uniform Stock Transfer Act, is estopped from denying the validity of the certificate so issued. *Foley v. Watertown Central Heating Co.*, (1933) 61 S.D. 488, 249 N.W. 815.

³¹⁴ Where a certificate is lost in the course of issuance, the stockholder is not required to comply with a by-law providing that a bond must be given in case of loss of the certificate issued. *Smith v. Universal Service Motors Co.*, (1929) 17 Del. Ch. 58, 147 A. 247.

duplicate certificate.³¹⁵ If it refuses to do so, the corporation subjects itself to liability for damages.³¹⁶

The rights of a bona fide holder of the old certificate which allegedly has been lost, destroyed, or stolen are not affected by the issuance of the new certificate.³¹⁷ The corporation is lawfully bound to recognize him, as well as the bona fide holder of the new certificate,³¹⁸ as a stockholder. To protect the corporation, a court that directs the issuance of a new certificate will require the person requesting the replacement to furnish a bond to indemnify the corporation against any loss if the old certificate should reappear.³¹⁹ If the facts show that there is no danger of the reappearance of the certificate, the court may order the issuance of a new certificate in place of the lost or mislaid original, without requiring a bond.³²⁰ A corporation that issues a new certificate without a court order will require the indemnity bond as a condition of issuance.

Levies upon stock. Shares of stock are not subject to levy³²¹ attachment,³²² or garnishee proceedings³²³ to satisfy the debts of stockholders unless the statute so provides. The statutes of most states, however, specifically subject shares of stock to legal process in the same manner as other personal property.

The manner in which the attachment or levy shall be made, the duties imposed upon the corporate officers to assist in the process upon presentation of proper writs, and the penalties exacted upon failure to comply with statutory requirements are generally set forth in the statutes. If the statutory provisions as to the mode of levy, attachment, or garnishment are not substantially complied with, the proceedings are of no effect.³²⁴

³¹⁵ See cases cited in Note 311, *supra*.

³¹⁶ *First Nat'l Bank v. Brown*, (1924) 117 Kan. 339, 230 P. 1038.

³¹⁷ For the rights of a bona fide purchaser of a stolen certificate, see p. 933 et seq.

³¹⁸ *People's Bank v. Lamar County Bank*, (1915) 107 Miss. 852, 67 So. 961.

³¹⁹ *Davis v. Lime Cola Bottling Works*, *supra* (Note 312); *Will's Adm'r v. George Wiedemann Brewing Co.*, *supra* (Note 311); *State ex rel. McCay v. New Orleans Cotton Exchange*, (1905) 114 La. 324, 38 So. 204.

³²⁰ *Ibid*.

³²¹ *Yazoo & M.V. R.R. v. City of Clarksdale*, (1921) 257 U.S. 10, 42 S. Ct. 27.

³²² *Gundry v. Reakirt*, (1909) 173 F. 167.

³²³ For discussion of problems involved in garnisheeing stock, see 39 MICH. L. REV. 482 and cases cited therein.

³²⁴ *Younkin v. Collier*, (1891) 47 F. 571; *Cramer v. McDonald*, (1931) 213 Iowa 454, 239 N.W. 101.

Troublesome questions sometimes arise upon conflicting claims to the stock made by attachment creditors and by transferees of the debtor. Ordinarily, if title to the shares of stock has been transferred by the debtor to a bona fide purchaser, the latter's right is not affected by a *subsequent* levy under execution or attachment.³²⁵ However, where recording on the corporate books or filing with some public officer is required to complete the transfer, the right of the transferee under an unrecorded or unfiled assignment is subordinate to that of a subsequent execution creditor.³²⁶

Where shares have been attached *prior* to a transfer, the attachment creditor generally acquires a right superior to that of a subsequent bona fide transferee, even if the latter purchased for value without notice of the attachment.³²⁷ It has been held, however, that a corporation may not refuse to transfer stock merely because it has been attached.³²⁸

Priorities between attachment creditors and transferees are sometimes fixed by statute.

A purchaser of stock upon an execution sale acquires title in the same manner as do purchasers of other personal property.³²⁹ He has the same right to have the transfer recorded on the corporate books³³⁰ as an ordinary purchaser or transferee.³³¹ The statutes some-

³²⁵ *Scott v. Pequonnock Nat'l Bank*, (1883) 15 F. 494. A pledgee's right is superior to that of a subsequent judgment creditor of the pledgor. *Bailey v. Pierce*, (1927) 123 Kan. 359, 255 P. 37; *Alta-Cliff Co. v. Spurway*, (1934) 113 Fla. 633, 152 So. 731; *Ahern v. Tulare Lake Canal Co.*, (1931) 115 Cal. App. 93, 1 P.(2d) 490.

³²⁶ *Fahrney v. Kelly*, (1900) 102 F. 403; *Sutter Inv. Co. v. Keeling*, (1932) 123 Cal. App. 323, 11 P.(2d) 418. This rule has been limited in some cases to requirements in the statute and charter. Where the requirement for recording is found only in the by-laws, it has been held that a transferee under an unrecorded transfer acquires a right superior to that of a subsequent attachment creditor. *Reilly v. Absecon Land Co.*, (1908) 75 N.J. Eq. 71, 71 A. 248. See also *Richman v. Bank of Perris*, (1929) 102 Cal. App. 71, 282 P. 801.

³²⁷ *Shenandoah Valley R.R. v. Griffith*, (1882) 76 Va. 913.

³²⁸ See *Ramage v. Gould*, (1917) 176 Cal. 746, 169 P. 670. In this case, it was stated that the levy of an attachment does not deprive the owner of the shares of his title. He still owns the stock and may exercise all of the rights of ownership, subject to the lien of the attachment. He may sell and transfer the shares, subject to the attachment.

³²⁹ A purchaser at an execution sale obtains the rights of a registered owner of the stock at the time of the execution sale. *Hollingsworth v. Multa Trina Ditch Co.*, (1931) 51 F.(2d) 649. If the shares stand in the name of some person other than the true owner, the latter may assert his right to the stock as against an attaching creditor of the nominal owner. *New York Commercial Co. v. Francis*, (1897) 83 F. 769.

³³⁰ *Wetumpka Bridge Co. v. Kidd*, (1900) 124 Ala. 242, 27 So. 431.

³³¹ A transfer officer of a corporation may be compelled, by *mandamus*, to make

times require that the corporation issue a certificate of stock to the purchaser at the attachment sale. It has been held that if no such statutory requirement exists, a corporation that refuses to issue a new certificate to the purchaser at the attachment sale will not be liable to the purchaser for the value of the shares.³³²

Taxes affecting transfers of securities. The corporation and its transfer agent, as well as the security holder, are concerned with the following kinds of taxes upon the transfer of stocks and bonds: (1) federal stamp tax; (2) state stamp taxes; (3) federal estate tax; and (4) state inheritance and estate taxes. The laws imposing these various taxes create certain obligations which the corporation must comply with before it undertakes to effect a transfer of securities from one owner to another. The tax laws affecting transfers of securities are extremely diverse in their provisions and are constantly undergoing changes by amendments of the statutes, by judicial interpretation, and by the issuance of administrative rulings and regulations. For these reasons, the subject of taxation is not treated in detail in this book.³³³

a transfer of stock to a purchaser at an execution sale of stock upon which levy was made to satisfy a judgment against a stockholder. *Mixson v. First Nat'l Bank of Miami*, (1931) 102 Fla. 468, 136 So. 258.

³³² *Harris v. Mid-Continent Life Ins. Co.*, (1919) 75 Okla. 105, 182 P. 85. It was stated that, while the purchaser of stock becomes the owner of the shares, and is entitled to all the rights and privileges of a stockholder, he must rely upon the same evidence of title as the purchaser at an attachment sale of any other class of personal property.

³³³ For complete and up-to-date information on any tax law, see *Prentice-Hall Stock Transfer, Federal Taxes, and State and Local Taxes*.

CHAPTER 23

RULES FOR TRANSFER OF SECURITIES

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Rules for Transfer of Securities

Desirability of rules for transfer. Every corporation that handles its own transfers of securities, every transfer agent, and every registrar, is faced constantly with the necessity of checking on the sufficiency of the documents and endorsements covering proposed transfers. In addition, inquiries concerning transfer requirements are continually received.

No matter how well grounded particular clerks or employees may be in the rules of law concerning transfers of securities, the desirability of a uniform guide is obvious. Particularly is this so in cases where different employees might give varied interpretations to the same principles of law. Furthermore, numerous problems concerning the adequacy of documents required for transfer result from determinations of corporate policy, based upon the advice of counsel and peculiarly inherent in given corporations. Accordingly, most corporations, as well as transfer agents, that have a large volume of stock transfers prepare circulars outlining their requirements for transfer. These circulars are used by employees engaged in the actual transfers, and are sometimes sent in answer to inquiries.

Rules for transfer of securities. The rules set forth in the following paragraphs have been prepared as a guide for the ultimate preparation by transfer agents of their own circulars on this subject. Before issuing a circular, the corporate secretary, with the aid of counsel, should check these rules against the law of the state of incorporation, and, in addition, there should be a canvassing of the entire subject on questions of policy. The rules have been grouped as follows: (1) documents required for transfer; (2) execution of assignments; and (3) registration and issuance of new certificates.

DOCUMENTS REQUIRED FOR TRANSFER

1. Transfers by agents.

(a) An original or duly certified copy of the power of appointment under which the agent derives his authority to make the transfer. *A transfer by the agent to himself as an individual should not be made unless the transfer is explicitly authorized under the terms of the power or by a decree of a court of competent jurisdiction.*

(b) A statement showing who has the custody of the original power of attorney.

(c) Satisfactory evidence that the principal was living on the date when the assignment was executed by the agent, and that the power of attorney was in force and in effect on that date. The guaranty of a responsible bank or stock exchange firm, indorsed on the copy of the power of attorney to be filed, or set forth in a separate instrument, is sufficient.

(d) An assignment of the security executed by the agent as indicated in Rule 17.

(e) Any other instruments that, under the terms of the power of attorney or under the statutes of the state in which the power is exercised, may be necessary to evidence the authority of the agent to make the transfer.

(f) Under Sec. 1491 et seq. of the Internal Revenue Code, a tax is imposed upon certain transfers of stocks and securities to foreign corporations, trusts, and partnerships. Transfer agents are required to report such transfers in accordance with the following ruling of the Internal Revenue Service:

Transfer agents to file statements.—Under Sec. 1491 of the 1954 Internal Revenue Code there is imposed upon the transfer of stock or securities by a citizen or resident of the United States, or by a domestic corporation or partnership, or by a trust which is not a foreign trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign trust, or to a foreign partnership, an excise tax equal to 27½ per cent of the excess of (1) the value of the stock or securities so transferred

over (2) its adjusted basis (for determining gain) in the hands of the transferor. Under Sec. 1492 this tax does not apply if the transferee is an organization exempt from income tax under Sec. 501-504 (except an organization described in Sec. 401(a)), or if prior to the transfer it has been established to the satisfaction of the Commissioner that such transfer is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes.

Every transfer agent making a transfer described in Sec. 1491 should make a return on Form 926 to his District Director on the same day the transfer is made, and pay the tax due. If it is claimed the transfer is non-taxable under Sec. 1492, Form 926 should be accompanied by (1) the Commissioner's letter approving the plan as one not having as one of its principal purposes tax avoidance, or (2) a certificate establishing the transferee's exemption under Sections 501 to 504 (or a copy of the Commissioner's letter so holding) [*Reg. §1.1494-1*].

2. Transfers by bankrupts.

(a) If the transfer is being made by the bankrupt to the receiver, a certified copy of the order appointing the receiver.

(b) If the transfer is being made to a third party, a letter or certificate signed by a bank or a member of the stock exchange, certifying that the securities were purchased for value prior to the failure of the transferor, and that the securities were not delivered in payment of an antecedent indebtedness within four months of the bankruptcy; or certifying that the stock was held as collateral security for a loan to the bankrupt, that the loan agreement authorized the sale, and that the delivery of the shares did not constitute a voidable preference under the Federal Bankruptcy Act.

3. Transfers by receivers or trustees in bankruptcy.

(a) A certificate of appointment of the receiver or trustee, with proof that the receivership or trusteeship is still in force.

(b) Proof of the authority of the receiver or trustee to transfer. Evidence of authority may be found either in the order of appointment or in a separate order authorizing the transfer.

(c) An assignment executed by the receiver or trustee personally. (See Rule 27.)

(d) Where a transfer is being made by a person or corporation in the hands of a receiver, to a third party, the transfer agent should require either a release from the receiver or a statement signed by a bank or a member of the stock exchange, certifying that the securities were purchased for value prior to the receivership; or certifying that the securities were held as collateral for a loan, and that the loan agreement authorized the sale of the securities.

4. Transfers by corporations.

(a) Proof of the authority of the officers of the corporation transferring the stock. This authority may be found in one or more of the following:

(1) A copy of the charter or articles of incorporation, certified and sealed by the Secretary of State.

(2) A copy of the by-laws, authorizing the execution of assignments of securities, duly certified by the secretary of the corporation as being in force at the time of the transfer, and sealed. If the by-laws make it the duty of the finance committee to pass upon a transfer, a certified copy of the resolution of the finance committee should also be required.

(3) A copy of a resolution of the board of directors, authorizing the transfer and naming the officers delegated to execute the assignment. This copy should be certified by the secretary of the corporation as being a true copy from the minutes, and should be sealed. If the resolution is of continuing effect, the secretary should certify that the resolution is in effect at the time of the intended transfer.

(b) If the officers authorized in the charter, by-laws, or a resolution to transfer are mentioned only by title, as for example, president, treasurer, or any vice-president and secretary, etc., proof that the officers signing have been duly elected to their respective offices.

(c) The authentication of the by-laws and of the resolution should be executed by an officer other than the one authorized to execute the assignment. If there is only one officer, the by-laws and the resolution should be certified by a quorum of the board of directors.

(d) An assignment of the securities executed as indicated in Rule 19.¹

(e) Any other papers that, under the terms of the charter or of the by-laws, may be necessary to authorize the transfer.

(f) If the transfer is being made to a director or officer of the corporation as an individual, a resolution of the board of directors specifically authorizing the transfer, and duly certified by an officer other than the proposed transferee, should be required. The transfer officer should make special inquiry as to the validity of the transfer.

(g) If stock stands in the name of a nominee who has left the employ of the corporation, and the nominee has not executed an assignment of the stock, a guaranty should be required before the transfer is permitted.

5. Transfers by associations.

(a) A copy of the constitution or charter and a copy of the by-laws, duly certified by the secretary of the association.

(b) Proof of the authority of the officer or agent making the transfer, as evidenced by a resolution of the governing body authorizing the transfer, duly certified.

(c) An assignment executed by the authorized officer or agent as indicated in Rule 19 (properly sealed, if a seal is required).

(d) When an organization changes its name by legal process and requests a transfer from the old to the new name, a certified copy of the order effecting the change should be required.

(e) If the security is registered in a trade name, evidence must be furnished that the person making the transfer is the sole owner of the securities.

6. Transfers by executors or administrators.

(a) If the decedent died testate, a certified copy of the will is necessary. The transfer officer should see that the will does not restrict the transfer of the particular securities involved.

¹ See Rule 185, New York Stock Exchange rules, on page 1009.

(b) A probate certificate or a certificate showing the granting of letters testamentary or letters of administration, properly certified, and evidence that such letters are still in force at the time of the intended transfer.

(c) If the statute of the state governing the powers of the executor or administrator requires an order of court to authorize the transfer, a duly certified copy of the court order should be required. If the statute contains other requirements for transfer, proof of compliance with such statutory requirements is necessary.

(d) If distribution is made prior to the expiration of the legal time for the payment of debts, proof of authorization by the court, or an affidavit of the executor or administrator that all debts have been paid or have been provided for, should be required.²

(e) Evidence of the payment of inheritance and estate taxes, or in lieu thereof, waivers issued by the proper authorities.

(f) An assignment of the security, executed by the executor or administrator (see Rule 20). If a corporation acts as an executor or administrator, proof must be furnished of the authority of the officers executing the assignment. Where securities form part of a trust created by the will, an assignment executed by the executor or administrator should nevertheless be required. An assignment by the trustee alone is not sufficient.

(g) If an executor or administrator desires to transfer securities from a decedent's estate to himself as an individual, he must furnish, in addition to other documents, proof of his right to do so. A certified copy of the order of distribution of the estate, and an affidavit that all prior legacies, if any, and all claims against the estate have been paid in full or have been provided for, should be required.

(h) Where securities standing in the name of a decedent were held by him merely as nominee or trustee, the transfer officer, before transferring the stock, should require either: (1) an assignment executed by the legal representative of the estate, and all other usual docu-

² Even if the laws of the state governing the powers of the executor or administrator prohibit distribution for a fixed period, a corporation may not refuse to make transfers during that period. As a matter of practice, however, some transfer agents require this affidavit.

ments required upon a transfer by executors or administrators; or (2) a release executed by the legal representative of the decedent's state, evidence of the appointment of such legal representative, inheritance tax waivers, where such waivers are required upon the transfer of stock standing in the name of a decedent, an assignment executed by the substituted trustee, and proof of the appointment of the substituted trustee.

(i) Transfers should be made in accordance with the order for distribution. Even if a beneficiary named in the order has died in the meantime, the transfer should be made as indicated in the order. However, if all the distributees agree to a distribution other than that indicated in the order, a different distribution may be made. For example, if the order authorized transfer to several beneficiaries, transfer may be made to one beneficiary, provided that all the others agree.

(j) The usual documents should be required, even if the securities forming part of the decedent's estate are registered in the name of another person. In addition, an assignment executed by the record holder must be submitted, and his signature duly guaranteed.

(k) If the transfer is being made to a beneficiary, and the order of the court that has been submitted authorizes a sale, proof should be furnished that the shares have actually been sold to the beneficiary.

(l) If a transfer is being made to a second legatee under the will, proof of the death of the first legatee must be submitted. For example, if the will bequeaths stock to *A*, but if *A* is not living at the time of the testator's death, then to *B*, proof of *A*'s death must be submitted before a transfer may be made to *B*.

(m) If a transfer is requested by the executor to someone other than the sole beneficiary under the will, the consent of the sole beneficiary should be required, as well as an affidavit of the executor that all debts and claims against the estate have been paid or have been provided for.

(n) Where the executor requests a transfer of stock to various legatees in unequal amounts, under a provision of the will requiring that the particular securities are to be equally divided among the

legatees, the transfer agent should require proof of the authority of the executor to make the unequal distribution. No such proof is required if the will simply directs an equal distribution of property without designating the particular securities submitted for transfer.

7. Transfers from decedents without probate proceedings.

(a) If the statute governing the distribution of the estate permits distribution without probate proceedings, a transfer may be made without probate of the estate upon the furnishing of the following:

(1) Proof of compliance with statutory requirements, such as an order of court or a statement of facts, guaranteed by some reputable bank or trust company.

(2) Proof of payment of inheritance and estate taxes, or waivers in lieu thereof, issued by the proper federal and state authorities.

(b) Where it is claimed that securities were assigned and delivered for value before the owner's death, proof thereof must be furnished.

(c) Where a small amount of stock is involved, and such stock constitutes the entire estate, a corporation may make a transfer directly to the heirs without probate or administration proceedings, upon the furnishing of a surety bond.

8. Transfers by guardians or committees.

(a) A certificate showing the appointment of the guardian or committee, or a copy of letters of guardianship or committeeeship, duly certified, and proof that the letters are still in force.

(b) If a guardian was appointed by will, a certified copy of the will.

(c) Proof of compliance with requirements of the statutes governing the powers of the guardian or committee upon a transfer. (A careful check should be made to ascertain whether a court order is required.)

(d) An assignment executed by the guardian or committee as indicated in Rule 18. If a corporation is acting as a fiduciary, proof of the authority of the officers executing the assignment should be required.

(e) If a transfer is being made from the guardian or committee to his ward, proof of the termination of the guardianship or committee-ship, as for example, a certified copy of a court order, a birth certificate showing that the ward has come of age, or proof of the competency of the ward and the discharge of the committee.

(f) If a ward has died, all documents required upon transfer from a decedent's estate must be furnished, in addition to the foregoing documents. (See Rule 6.)

(g) If the security is registered in the name of a minor, the transfer must be made by a duly appointed guardian, or a bond of indemnity must be furnished.

(h) If a transfer is being made from the name of an incompetent to the name of the committee, proof of the appointment of the committee should be required.

9. Transfers by trustees.

(a) The original or a duly certified copy of the instrument creating the trust. (See Rule 16.)

(1) An extract from the trust instrument *is not sufficient, even if it is duly certified*. But see 9 (f).

(2) The transfer officer should see that the instrument of trust does not restrict the transfer of the particular securities involved.

(b) Satisfactory evidence of the appointment of the trustee and of the retention of the trustee at the time of the intended transfer, where the assignment is executed by trustees other than those named in the instrument of trust, and where the statutes of the state in which the trust is administered, require a judicial ratification of the appointment.

(c) An order of a court of competent jurisdiction, authorizing the transfer:

(1) If the statute of the state to whose laws the trust is subject requires an order.

(2) If the trust instrument has been lost.

(3) If the transfer is to the individual name of the trustee, unless such transfer is explicitly authorized under the terms of the trust instrument.

(4) When a trustee has been appointed for an absent legatee.

(5) If the trust instrument does not authorize a sale. Securities that are nonlegal investments, forming part of a trust estate, may be transferred without a court order, even if the trust instrument does not specifically authorize a sale.

(d) Any other papers that, under the terms of the trust instrument or under the statutes of the state in which the trust is administered, may be necessary to show the authority of the trustees to make the requested transfer.

(e) Inheritance tax waivers.

(f) In case of voluntary trust indentures, a photostat copy, certified to by a bank or trust company, may be accepted in lieu of the original instrument.

(g) An assignment executed by the trustees as indicated in Rule 21.

(1) *All the trustees must sign*, unless the statute of the state governing the transfer or trust instrument provides otherwise.

(2) If a trustee has died, proof of the death of the deceased trustee should be submitted.

(3) If a trust instrument authorizes transfer by the surviving trustees, and an assignment is executed by a sole surviving trustee, proper proof of the death of the other trustees should be required.

(4) If an order authorizing a transfer grants authority to transfer to a designated person as surviving trustee, proof of the death of the deceased trustee is unnecessary.

(5) Substituted trustees should furnish evidence of their appointment.

(6) If a corporation acts in a fiduciary capacity, proof should be furnished as to which officers are authorized to execute the assignment.

(h) If no trust exists, proof of the facts involved in the registry of the stock in the name of the trust, and in the proposed transfer, should be required.

10. Transfers by joint tenants.

(a) If one of the joint tenants has died, proof of the payment of inheritance and estate taxes, or waivers in lieu thereof.

(b) If one of the joint tenants has died, an assignment by the legal representative of the deceased tenant or a release of the securities should be furnished, if the laws of the state governing the tenancy do not recognize the right of survivorship.

(c) If such laws recognize the right of survivorship, upon the death of one joint tenant, a transfer may be made to the surviving tenant in his individual name, upon proof of the death of the other tenant. A death certificate or a probate certificate, showing the appointment of an executor or administrator, may be accepted without the presentation of any assignment by the executor or administrator. If the name on the death certificate differs in any respect from the name given on the certificate of stock, an affidavit that the persons named in the two certificates are identical should be required.

(d) For the execution of an assignment by joint tenants, see Rule 23.

11. Transfers by tenants in common.

(a) If both tenants have died, all documents required upon transfer from the name of a decedent should be furnished for each of the tenants, the assignments being executed by the legal representatives of each estate (see Rule 6).

(b) If one tenant has died, the transfer officer should require, in addition to an assignment executed by the survivor, all the documents generally required upon the transfer of stock standing in the name of a decedent (see Rule 6).

(c) It may be presumed that stock registered in the name of two or more persons is held as a tenancy in common and not as a joint tenancy.

(d) For execution of an assignment by tenants in common, see Rule 23.

12. Transfers by partners.

(a) If both partners are dead, proof of the payment of inheritance and estate taxes, or waivers in lieu thereof, in both estates, are required.

(b) For the execution of an assignment by partnership, see Rule 25.

13. Transfers by persons with limited interests.

(a) If stock is registered in the name of a life tenant as such, it may be transferred to the life tenant as an individual, upon the furnishing of a release, properly executed by the sole remainderman, provided that the remainderman is competent to act.

(b) Proof of the death of the life tenant must be submitted before a transfer will be made to the remainderman. Inheritance tax waivers should also be submitted where the statute requires the payment of such taxes.

14. Transfers by pledgees.

(a) The original agreement of pledge.

(b) Proof of compliance with the requirements of the statutes and the pledge agreement governing the sale upon default.

(c) If neither the agreement nor the statute makes provision for the sale upon default without notice and without foreclosure, proof that reasonable public notice of sale has been given, or a certified copy of the foreclosure decree, should be required.

(d) An assignment, duly executed by the pledgee.

(e) If the pledgor has died, proof of the payment of inheritance and estate taxes, or waivers in lieu thereof, should be submitted, in addition to the usual documents.

15. Upon change of name.

Where an individual name has been legally changed, a transfer from the old name to the new may be made upon the furnishing of a certified copy of the decree effecting the change. (For the execution of an assignment upon a change of name, see Rule 22.)

16. General documentary requirements.

(a) If an instrument to be submitted upon transfer is a matter of public record, the original or a certified copy of the original, properly authenticated by the certificate and seal of the recording officer, should be required. If a return of the instrument submitted is desired, a notarially certified copy should be furnished for filing in the transfer office. If the instrument is from a foreign jurisdiction, the authority of the notary should be exemplified by the proper county (and/or court) officer. (See (e), below.)

(b) If an instrument to be submitted upon transfer is not a matter of public record, the original, satisfactorily authenticated, should be submitted. A notarially certified copy should be presented for filing if a return of the original is desired.

(c) Recorded instruments should be returned by the transfer officer promptly. Copies thereof or relevant extracts should be kept in the files of the transfer office.

(d) Copies of court orders evidencing authorization to transfer must be submitted in full. Certified extracts should not be accepted.

(e) Signatures of notaries not known at the transfer office should be verified by the proper county clerk. Documents executed beyond the territory of the United States should be verified by a United States consul.

RULES FOR EXECUTION OF ASSIGNMENT

17. By agent.

(a) The assignment of the certificate should be signed by the agent in his capacity as such. For example, "Adam Lane, by Charles Crane, Agent."

(b) Where the security registered in the name of the agent indicates the name of the principal, the principal may execute the assignment. For example, if the registration is in the name of "Charles Crane, Agent for Adam Lane," the assignment may be executed by Adam Lane. Execution of the assignment by the agent is, however, preferred.

18. By committee or guardian.

(a) The assignment should be signed by the committee or guardian in a representative capacity.

(b) If the security is registered in the name of more than one person as committee or guardian, each person must execute the assignment.

19. By corporation or association.

(a) The assignment should be executed by the officer authorized to transfer securities. For example, "A.B.C. Corporation, by Richard Payne, President."

(b) The officer who makes the assignment should acknowledge it before a notary public. If the acknowledgment is taken outside of the state, a certificate of notarial authority should be attached.

(c) The corporate seal should be impressed on the assignment whether the assignment is indorsed on the security itself or executed on a detached stock power.

20. By executor or administrator.

(a) The assignment must be executed by the executor or administrator in his representative capacity.

(b) *The power to sign cannot be delegated to an agent.*

(c) Where there are two or more executors or administrators, the statute of the state governing the powers of the executors or administrators should be examined to determine who may execute the assignment.

(d) For an assignment by a trustee-executor, see Rule 21 (e).

(e) In an assignment of stock by an executor from the name of the decedent to himself as executor, the signature on the assignment need not be guaranteed. A guaranty is required, however, where the assignment is made to the executor as an individual.

»»**WARNING**→ Any transfer by an executor, administrator, or trustee to himself, individually, is open to serious question unless authorized by a *specific* court order. The consideration for the transfer should be *specifically* set forth.

(f) If, prior to the transfer of stock, an estate is closed, it should be reopened so that the original executor or administrator may execute the assignment. If the original executor or administrator has died, the assignment should be executed by a special administrator, appointed by the court.

21. By trustees.

(a) The assignment should be executed by the trustee in his representative capacity. (See WARNING in Rule 20.)

(b) All living trustees must sign the assignment, unless the trust instrument authorizes less than all of the trustees to pass title.

(c) If a co-trustee has died, proof of death, such as a certificate of death, when obtainable, or a credible affidavit, should be required as a condition precedent to transfer.

(d) In case of a vacancy of one or more trustees, due to any cause, satisfactory evidence thereof must be filed.

(e) Where the trustee is also the executor of the estate, but the transfer is not made in the regular course of administration, the assignment should be executed by the holder both as trustee and as executor.

22. Upon change of name.

Where a transfer is being made from the maiden name to the married name of a stockholder, or from an old name to a new name, changed by legal procedure or otherwise, the assignment should be executed as follows: "Mary Lane, now Mary Lane Jones"; or "Sunshine Co., now The Merry Sunshiners."

Evidence of identity may be required. See also Rule 15.

23. By joint tenants and tenants in common.

Each tenant must sign the assignment.³

24. By married woman

If the security is registered in the name of a person who is a married woman, or if the corporation knows that such person is married, the statutes of the state whose laws govern the powers of a married woman should be examined to see if such person may assign the security without the consent of her husband.⁴

25. By partnership.

(a) The signature must be the established and legal signature of the firm.

(b) While the assignment may generally be executed by signing the firm name, if the circumstances are such as to place the transfer agent upon inquiry as to the authority of the partner executing the assignment, further proof of his authority to sign should be required.

(c) Where the securities are to be transferred to one of the members of the firm, each member of the firm must affix his signature to the assignment. In lieu thereof, the partners may indicate their consent by executing a separate instrument, the signatures on which must be guaranteed.

(d) If all partners are dead, the executor or administrator of the partner who died last should execute the assignment, in the absence of any contrary provision in the agreement of partnership.

(e) Where a transfer is being made to a new partnership, formed to assume the business of the old partnership, the assignment should be executed by all the partners of the old firm. If one member is authorized to effect the transfer, an assignment executed by him alone may be accepted if evidence of his authority is furnished.

(f) If a firm executing an assignment has dissolved, and is suc-

³ See Rule 192, New York Stock Exchange rules, on page 1011.

⁴ See Rule 194, New York Stock Exchange rules, on page 1011.

ceeded by a firm or firms having as general partners some of the general partners of the dissolved firm, the assignment may be accepted if the new firm or one of the new firms signs a statement reading "Execution Guaranteed," under a date subsequent to that on which the new firm so signing was formed.

26. By persons with limited interest.

During the life of the life tenant, assignments must be executed both by him and by the remainderman, unless the will gives the life tenant the power to transfer, or unless it confers such authority upon a trustee.

27. By receiver.

The assignment must be executed by the receiver himself. *The power to do so may not be delegated to an agent.*

28. Guaranty of signature on assignment.

(a) If the signature on the assignment is not known to the transfer agent, it must be guaranteed either by: (1) an establishment represented on the stock exchange; or (2) a state or national bank or trust company.

(b) The signature on the guaranty should be that of an officer and his official title should be affixed thereto. In guaranties by banks or trust companies, the transfer agent should see that the guaranty is by the bank and that it is not merely a personal guaranty by an officer.

(c) Even if the guaranty is executed by a member of the stock exchange, the transfer agent should refuse to accept it if the signature is unknown to him.

(d) If the guaranty is by a corporation, the proper officer of the corporation should affix his official signature and title, in addition to the name of the corporation. For example, "Arcade Co., Inc., by Benjamin Cass, President."

(e) When the broker through whom the stock was sold is not a member of the stock exchange, the transfer agent should require, in

addition to the broker's guaranty of the signature, the guaranty of a member of the exchange. The transfer agent should be sure that the member guarantees the signature of the person executing the assignment, and not merely the signature of the broker.

(f) The guaranty must be unconditional and unqualified. The transfer agent should insist that the guaranty simply read "Signature Guaranteed."

(g) A guaranty by an out-of-town bank or trust company having no local correspondent should not be accepted.

(h) The guaranty should appear on the assignment itself, and not in any separate instrument.

(i) No guaranty is required where securities are registered in the name of an out-of-town bank or trust company. Identification by the New York correspondent of the bank or trust company is sufficient.

(j) A signature may be guaranteed by an officer of the corporation issuing the stock.

(k) The firm guaranteeing the signature must be in existence at the time the security is presented for transfer. If it has gone out of business, or if it has been consolidated, merged, or suspended for insolvency since the time of the guaranty, the guaranty should not be accepted.

(l) The guarantor and the transferee may be the same person.

(m) No guaranty of signature is required or permitted on assignments of United States Government bonds.

(n) Where the assignment is executed by a person or corporation whose signature would be accepted as a guaranty, no signature guaranty need be required.

29. General rules covering signature on assignment.⁵

(a) The signature on the assignment must correspond in every particular with the name in which the security is issued, without

⁵ The complete rules of the New York Stock Exchange governing the documents required for transfer and the rules governing signatures on assignments will be found on pages 1008 to 1015.

abbreviation, enlargement, or change. For example, if the certificate is registered in the name of "Adam James Beard," the assignment should be signed "Adam James Beard," and not "Adam J. Beard"; or, if the name of the registered holder is prefixed by "Dr.," "Capt.," "Miss," "Mrs.," "Rev.," and the like, the signature must include such prefix.

(b) If the signature does not correspond in every particular with the name in which the security is issued, the assignment may nevertheless be accepted, upon the furnishing of a guaranty by a bank or trust company or by a member of the stock exchange, to the effect that the person indorsing the certificate is the same person whose name appears on the face of the certificate.

(c) If the security has been issued in a name incorrectly stated or wrongly spelled, the assignment must be executed both in the registered and in the correct name.

(d) The assignment may be signed by a mark. The mark should, however, be duly witnessed and guaranteed.⁶

(e) Pencil signatures may be accepted, although it is advisable to require assignments to be signed in ink. It is general practice to accept signatures made by pen, ball-point pen, or indelible pencil.

30. Several signatures.

Each signature should be witnessed and guaranteed. Where there are two or more signatures to an assignment, the witness should indicate in his own handwriting which signature he is witnessing.

31. Date on assignment.

(a) The assignment should be dated.

(b) The date need not be recent. If, however, the corporation is put on notice of the death of the transferor, it must require the documents as indicated in Rule 6.

⁶ Many transfer officers require two witnesses to sign the following guaranty:

"We certify that the assignment was read to the assignor in our presence, that he made his mark in our presence, and that he signified his intention thereby to transfer the shares of stock represented by this certificate."

(c) An assignment to a successor trustee by the resigning trustee may be dated subsequent to the effective date of resignation.

32. Alterations in assignment.

(a) Any alteration or correction must be accompanied by an explanation on the original instrument, signed by the person executing the assignment.

(b) If the signature has been altered in any way, the assignment should not be accepted. The transfer agent should require a guaranty of the signature as altered.

33. Filling an assignment or power of attorney.

(a) If the power of attorney has been filled in with the name of an individual or firm other than the transfer officer, as attorney, a power of substitution should be required.

(b) If an assignment is executed in blank, the transfer agent should insist that the name of the transferee in whose name the new certificate is to be issued, be presented in writing, signed by the person who offers the certificate for transfer, in order to avoid error. The address of the transferee should also be furnished for the corporate records.

34. Stock powers.

(a) Detached instruments of assignment must contain provision for the irrevocable appointment of an attorney with power of substitution, and a full description of the securities affected; for example, the name of the company, the class of stock, the certificate number, and the number of shares, written in words and numerals. The entire description of the security should be in the same writing.

(b) Detached powers of assignment should bear a date subsequent to the date of registration of the securities presented.

(c) Where an assignment is executed on a separate instrument, each certificate should be accompanied by a separate assignment.

(d) If, prior to the execution of the stock power, an assignment

has been indorsed on the back of the stock certificate, a release from the transferee under the earlier stock power or a guaranty of its cancellation should be obtained.

REGISTRATION AND ISSUANCE OF NEW CERTIFICATE

35. To agent.

The certificate should be issued in the name of the principal, and not in the name of the agent as such. However, if the principal and the agent agree, certificate may be issued in the name of the agent even without showing the agency. If the agency relation is to be shown, it should be in this form: "John Doe, agent for Richard Roe u/a dated , 19...."; or, "John Doe, attorney in fact for Richard Roe under a power of attorney dated , 19...."

36. To committee.

The certificate should be issued in the name of the committee, indicating the person for whom the committee is acting. A certified copy of the decree appointing the committee should be filed with the transfer officer.

See Rule 48 for issuance of stock to an incompetent.

37. To corporation or association.

(a) Registration should be in the title of the corporation or the association. If the name of a corporation designated as transferee does not contain the word "corporation" or "incorporated," a copy of its articles of incorporation, certified by the Secretary of State, under seal, or some other evidence that it is a corporation, should be submitted.

(b) Even if the name of the corporation designated as transferee does contain the word "corporation" or the word "incorporated," an officially certified copy of the articles of incorporation should be submitted, to facilitate a future transfer.

(c) Where the name is not that of a corporation or partnership, the following should be submitted: (1) proof of the legal nature of the organization; (2) evidence showing what representative of the organization is vested with authority to execute an assignment of the security; and (3) a copy of the by-laws or some other similar instrument, to facilitate a future transfer (see Rule 5).

(d) Securities owned by a person doing business under a trade name should be registered in his name as an individual. For example, if John Smith trades under the name of "The Smith Store," the security should be registered "John Smith," and not "John Smith, trading as The Smith Store."

38. To executor or administrator.

(a) The name of an executor or administrator should be followed by a brief description of the will or estate. For example, "Daniel Kane, Executor (*or* Administrator) of the Estate of Margaret Kane." Certificates should never be issued to "Estate of Kane," and the like.

(b) Stock may be registered in the name of the administrator or executor as such, even if the purchase of the stock by the legal representative was made without compliance with requirements of the statutes governing the powers of the legal representatives in regard to the obtaining of a court order.

(c) Where a legatee dies prior to the settlement of the estate and prior to the transfer of the stock from the name of the decedent, the certificate should be issued to the executor of the estate of the deceased legatee, and not directly to the beneficiary of the estate of the deceased legatee.

(d) Even if an executor is also a trustee, stock should be registered in his name either as executor or as trustee, but not as both at the same time.

39. To trustee.

(a) The name of the trustee should be followed by a brief description of the trust instrument under which the trust is created, whether

under a will or a deed of trust. For example, "John Smith and James Wade, Trustees under the will of Mary Dade," or "John Smith, Trustee under indenture date, 19. . . ., between and"

(b) If the instrument creates more than one trust, the trust clause should also be given. For example, "John Smith, Trustee for under the clause of the will of"

(c) When securities are to be registered in a particular form so as to indicate that they are impressed by a trust, the instrument creating such trust should be exhibited, and a certified copy thereof should be filed in the transfer office before registration. If this is done, the trust instrument need not be subsequently exhibited if a transfer is requested, and a future transfer by the trustee will be facilitated.

(d) If the appointment of the trustee is by decree of a court, a certificate evidencing the appointment should be filed at the time of registration.

(e) A certificate should not be issued in the name of a trustee merely for the convenience of the parties, where no trust actually exists.

(f) See Rule 38 (d), above, in regard to the issuance of a certificate to an executor and trustee.

40. To joint owners.

The full name of each joint owner must be given and the nature of the tenancy should be clearly indicated. For example, "Alice White and James White, as joint tenants with right of survivorship, and not as tenants in common."

41. To tenants in common.

The name of each of the tenants should be given in full, and the nature of the tenancy should be clearly indicated. For example, "Alice White and James White, as tenants in common."

42. To person with limited interest.

(a) Securities bequeathed to a beneficiary for life should not be registered in the name of the life tenant as an individual, but the life tenancy should be indicated. For example, "Mary Smith, life tenant under the will of Samuel Smith." The remainderman need not be identified in the form of registration.

(b) Where a will gives a limited ownership in stock other than a life tenancy, for example, "until Mary Smith remarries," the stock should be registered "Mary Smith, subject to the will of Samuel Smith."

43. To partnership.

(a) The certificate should be issued in the trade name of the partnership. A statement of the names of the partners should be submitted. [Compare Rule 37 (d).]

(b) The certificate may be issued in the names of the partners as such. For example, "Alfred Jones and Emanuel Smith, partners."

44. To married woman.

A certificate should be issued to a married woman in her own name. For example, "Mary Smith," and not "Mrs. John Smith." "Mrs. Mary Smith" is, however, sometimes used.

45. To minor.

The certificate should be issued thus: "Margaret Lund, a minor under the guardianship of John Doe."⁷ See also Rule 47.

46. To pledgee.

(a) Explicit reference to the pledge agreement should be made. For example, "Stephen Sand, pledgee under agreement with Michael Sand, dated , 19...."

(b) The pledge agreement need not be exhibited at the time of registration.

⁷ In states where there are special statutes permitting gifts of stock to minors, the statutory form of registration must be used. See *Prentice-Hall Stock Transfer Guide*.

(c) Stop notices should not be placed against stock held in pledge. The stock should be registered in the name of the pledgee.

47. To guardian.

(a) The certificate should be issued in the name of the guardian of a minor, *as guardian of the minor*.

(b) If the appointment is under a will, that fact should be noted, and proper evidence of the appointment should be filed with the transfer officer.

48. To incompetent.

If the stock is issued in the name of an incompetent, a notation of the disability and also of the fact that a committee has been appointed, should be made in the certificate. See Rule 36 for the method of registration preferred.

49. To individual.

(a) The certificate should be issued in the full name of the individual, without prefix, suffix, or title. For example: "John Smith," and not "Mr. John Smith"; "Jane Doe," and not "Miss Jane Doe." See also Rule 44. If, however, the transferee requests it, a title may be included as identification of the holder, provided that it is not confusing. For example, "Colonel Robert A. Hand," or "John D. Lane, Private Banker," is permissible. "E. Hill, Cashier,"⁸ is, however, confusing and should not be allowed.

(b) The first name should never be indicated by initials, but should be given in full.

(c) Stock should not be registered in the name of two individuals in the alternative, as for example, "Kate Mack or Mark Kane."

50. Split-up certificates.

The holder of certificates surrendered for split-up into certificates

⁸ See *Stamford Bank v. Ferris*, (1845) 17 Conn. 258, where an assignment to "E. Hill, Cashier," was held to be an assignment to the bank of which he was cashier, and not to himself as an individual.

of smaller denominations need not assign the original certificate. A charge for split-up may be made.

51. Permanent certificates.

Upon the issuance of permanent certificates to replace temporary certificates, temporary certificates should not be indorsed.

52. Fractional shares.

The issuance of fractional shares should be avoided if possible. If equal distribution cannot be made under an order requiring it, without the issuance of fractional shares, the transfer agent should try to procure from the distributees an agreement permitting distribution in such a way that only full shares need be issued. In some jurisdictions, fractional shares are not authorized.

53. General rules covering stop notices.

(a) The transfer officer should acknowledge receipt of all stop transfer notices and should make a notation of the stop on all the records. All registrars and co-transfer agents should be notified. Similar acknowledgments and notations should be made where notice is received to remove a stop transfer.

(b) Registrars and co-transfer agents receiving notice of a stop from the transfer office should acknowledge receipt thereof and should make a similar notation on all their records. Similar acknowledgments and notations should be made where notice is received to remove a stop transfer.

(c) If a stop transfer notice is received by the corporation, it should immediately notify the transfer office. If the notice is given to the transfer office, this office need not notify the corporation, unless it wishes the notice to serve as a warning to a corporation purchasing its own stock.

(d) If the stock is registered in the name of some person other than the true owner, the consent of the record owner to a stop notice requested by the true owner should be obtained.

(e) Stop notices should not be placed against stock merely because such stock has been given as collateral security. See Rule 46 (c).

(f) If the certificate upon which transfer has been stopped is presented for transfer, the record holder should be notified that if he does not wish to release the stop, proceedings must be instituted to determine the conflicting claims, or an indemnity bond must be furnished within a specified time. The transfer officer should advise the person presenting the certificate for transfer that a stop notice has been placed against it, and should delay making the transfer. If the stop is not released, and no action is instituted or no bond furnished within the specified time, the transfer agent should proceed to transfer the stock.

54. Lost certificates.

(a) If a holder desires a new certificate to replace one that has been lost, destroyed, or stolen, the holder should be advised that the following are required:

(1) An affidavit of the stockholder, setting forth the circumstances involved in the loss or destruction of the certificate.

(2) A bond of indemnity, approved by the directors of the corporation, in an amount double the par value of the stock, indemnifying the corporation, the transfer officer, and the registrar. The board of directors may by resolution approve acceptance of an open indemnity bond. See page 1099.

(b) A surety company bond should be required. The corporation, however, may authorize by resolution the acceptance of a personal bond if the by-laws of the corporation allow it. The directors may provide by resolution for a blanket bond protecting the corporation against loss resulting from replacement of lost certificates. In that case the stockholder is not required to provide a bond.

(c) A duplicate original of the bond should be given to the registrar.

(d) The affidavit of loss need not be given to the registrar.

(e) If, after the issuance of the new certificate, the old certificate

is presented for transfer, the old certificate should be marked "cancelled," and the transfer officer should immediately notify the surety designated on the indemnity bond. The certificate so cancelled may be returned to the person presenting it for transfer, upon his request.

55. Notices to co-transfer agents and co-registrars.

(a) All co-transfer agents should be notified of the issuance of certificates, upon original issuance and upon transfer.

(b) All registrars should be notified of all registrations of certificates, upon original issuance and upon transfer.

(c) Certificates issued by one transfer agent should not be transferred by any other transfer agent without notice from the issuing office that the transfer is regular.

(d) Transfers should not be registered by any registrar other than the one who originally registered the certificate, without notice from the latter that the transfer is regular.

56. Bonds.

If a bond that is interchangeably coupon and registered designates the owner by name, but does not indicate that such name has been registered, a transfer of the bond should not be made until such name is registered.

The requirements in the various states differ as to tax waivers upon the transfer of decedents' bonds. For a nonresident, the waiver is usually not required. For a resident, it is often mandatory.

New York Stock Exchange rules. The rules of the Board of Governors of the New York Stock Exchange contain a division entitled "Settlement of Contracts." This division consists of a series of rules, some of which regulate the requirements for documents accompanying securities that are to be transferred and requirements for the execution of assignments. The documents and assignments must comply with the requirements of these rules in order to constitute "good delivery."

Although the rules of the New York Stock Exchange are not the final and controlling law on the subject, they represent such an im-

portant body of usage that they are entitled to great respect. The applicable rules read as follows:

RULE 180. (*Assignments*) A certificate of stock, a registered bond, or other registered security shall be accompanied by a proper assignment, executed either on the certificate itself or on a separate paper, in which latter case there shall be a separate assignment for each certificate or bond.

RULE 181. (*Separate assignments*) A separate assignment shall contain provision for the irrevocable appointment of an attorney, with power of substitution, and a full description of the security, and shall be in the form approved by the Exchange. The number of shares of stock or the principal amount of a bond shall be expressed in both words and numerals.

(Special forms of assignment are required in assigning registered certificates of the corporate stock of the City of New York, which are obtainable at the office of the Comptroller of the City of New York.)

RULE 182. (*Power of substitution*) When the name of an individual, firm or member corporation has been inserted in an assignment, as attorney, a power of substitution shall be executed in blank by such attorney.

When the name of an individual, firm or member corporation has been inserted in a power of substitution, as substitute attorney, a new power of substitution shall be executed in blank by such substitute attorney.

RULE 183. (*Alterations or corrections*) Any alteration or correction in an assignment, power of substitution, or other instrument shall be accompanied by an explanation on the original instrument, signed by the person, firm or corporation executing the same.

RULE 184. (*Signatures*) The signature to an assignment or power of substitution shall be technically correct, i.e., it shall correspond with the name as written upon the certificate in every particular without alteration or enlargement, or any change whatever, except that "and" or "&," "Company" or "Co." may be written either way.

RULE 185. (a) (*Corporate assignments*) A certificate in the name of a corporation (except as provided in paragraph (b) hereof) or an institution, or in a name with official designation, shall be a delivery only if the statement "Proper papers for transfer filed by assignor" is placed on the assignment and signed by the transfer agent.

(b) (*Member corporation assignments*) A certificate in the name of a member corporation shall be a delivery provided the assignment is executed either (1) by the manual signature of an officer of such member corporation, or other person, authorized pursuant to Rule 187(b), or (2) by the mechanically reproduced facsimile signature of an officer of such

member corporation adopted in accordance with Rule 214(b), and the following statement appears on the assignment: "Authorizing resolutions filed with New York Stock Exchange."

RULE 186. (*Assignments by persons since deceased, trustees, guardians, etc.*) A certificate shall not be a delivery with an assignment or power of substitution executed by a

- (a) person since deceased,
- (b) trustee or trustees, except trustees acting in the capacity of a board of directors of a corporation or association, in which case Rule 185 shall apply,
- (c) guardian,
- (d) infant,
- (e) executor,
- (f) administrator,
- (g) receiver in bankruptcy,
- (h) agent, or
- (i) attorney, except as provided in Rule 187.

RULE 187. (a) (*Powers of attorney to employees*) A member or member firm may authorize one or more persons, who are either his or its employees or who are officers or employees of the Stock Clearing Corporation, to assign registered securities in the name of such member or member firm and to guarantee assignments, with the same effect as if the name of such member or firm had been signed under like circumstances by such member or by one of the partners of the firm, by executing and filing with the Exchange, in the form prescribed by it, a separate Power of Attorney for each person so authorized.

(b) (*By officer or employee of member corporation*) A member corporation may authorize one or more of its officers, or one or more other persons, who are either its employees or who are officers or employees of the Stock Clearing Corporation, to assign registered securities in the name of the member corporation and on its behalf and to guarantee assignments, by filing with the Exchange, in the form prescribed by it, a certified copy of resolutions of its Board of Directors, authorizing such person or persons so to act.

RULE 188. (*Insolvents*) A certificate with an assignment or power of substitution executed by an insolvent shall be a delivery only during the closing of the transfer books, during which time such a certificate shall be a delivery only if held by others than the insolvent and if it is accompanied by an affidavit that the said certificate was so held on a date prior to the insolvency and the signature to the assignment or power of substitution is guaranteed as provided in Rule 197.

RULE 189. (*Dissolved firms, member corporations*) A certificate with an assignment or power of substitution executed by a firm or member corporation that has ceased to exist shall be a delivery only during the closing of the transfer books, provided the execution of the assignment or power of substitution is properly acknowledged and the signature thereto is guaranteed as provided in Rule 197.

RULE 190. (*Continuing firms, member corporations*) A certificate with an assignment or a power of substitution executed by a member firm or member corporation that has since dissolved or ceased to be a member firm or member corporation and is succeeded by either

- (a) a member firm or firms having as general partners one or more of the general partners of the dissolved or former firm, or one or more of the holders of voting stock of the dissolved or former corporation; or
- (b) a member corporation or corporations having as holders of voting stock one or more of the general partners of the dissolved or former firm, or one or more of the holders of voting stock of the dissolved or former corporation,

shall be a delivery only if the new firm or corporation or one of the new firms or corporations, shall have signed the statement "Execution guaranteed" as of the date of or a date subsequent to the formation of the new firm or corporation so signing.

RULE 191. (*Change in firm or corporation name*) A certificate with an assignment or power of substitution executed by a firm or member corporation, the name of which has since been changed, shall be a delivery only if such firm or corporation shall have signed the statement "Execution guaranteed" as of the date of or a date subsequent to the change in name.

RULE 192. (*Joint tenancy; special designation, etc.*) A certificate with an inscription to indicate joint tenancy, or with a qualification, restriction or special designation, shall not be a delivery.

(*Tenancy in common*) A certificate with an inscription to indicate tenancy in common, shall be a delivery only if signed by all co-tenants.

RULE 193. (*Two or more names*) A certificate issued in the names of two or more individuals or firms shall be a delivery only if signed by all the registered owners.

RULE 194. (*Married women*) A certificate in the name of a married woman shall be a delivery, except that, where applicable law limits the right of a married woman to transfer the certificate, such certificate shall be a delivery only when the assignment shall be executed jointly by hus-

and wife and acknowledged before a notary public or other qualified officer.

RULE 195. (*Unmarried women*) (*Rule rescinded in 1956.*)

RULE 196. (*Widows*) (*Rule rescinded in 1956.*)

RULE 197. (*Guarantee*) Except with respect to registered securities of the United States Government, the signature to an assignment of a certificate not in the name of a member, member firm or member corporation shall be guaranteed by a member, member firm or member corporation or by a commercial bank or trust company organized under the laws of the United States or of the State of New York and having its principal office in the vicinity of the Exchange. Each signature to a power of substitution executed by other than a member, member firm or member corporation shall be guaranteed in like manner.

RULE 198. (*Member signature is guarantee*) An endorsement or guarantee of an assignment or power of substitution shall be a guarantee of the signature to such assignment or power of substitution, and shall be so a guarantee of the legal capacity and authority of the signer.

RULE 199. (*Out-of-town member executions*) A certificate with an assignment or power of substitution executed or guaranteed by a member, member firm or member corporation not having in the vicinity of the Exchange an office at which settlement of Exchange contracts is regularly effected shall be a delivery only if such assignment or power of substitution shall be (1) guaranteed by a member, member firm or member corporation having such an office in the vicinity of the Exchange or (2) stamped as follows by such member, member firm or member corporation first delivering it:

“Delivered by”
(Name of resident member, firm or corporation)

(b) A certificate with an assignment or power of substitution guaranteed by a commercial bank or trust company, as provided in Rule 197, shall be a delivery only if such assignment or power of substitution shall (1) guaranteed by a member, member firm or member corporation or (2) stamped as follows by the member, member firm or member corporation first delivering it:

“Delivered by”
(Name of member, firm or corporation)

RULE 200. (*Guarantee by insolvent*) A certificate with an assignment or power of substitution guaranteed by an insolvent shall be a delivery only if reguaranteed as provided in Rule 197.

RULE 201. (*Transfer books closed indefinitely*) The Exchange may in particular cases direct that assignments and powers of substitution on certificates of a company whose transfer books are closed indefinitely be properly acknowledged.

RULE 202. (*Transferees in error*) A certificate of stock on which the name of a transferee has been filled in error shall be a delivery during the closing of the transfer books, provided that:

- (1) statements as follows have been placed on the back of the certificate, signed and properly acknowledged:

- (a) *By Transferee:*

"I (we) have no interest in the within certificate of stock."

- (b) *and by Assignor:*

"Above power of attorney cancelled by me (us) and a new, detached assignment and power issued in lieu of it."

- (c) *and by Attorneys (if any):*

A separate statement as follows, with proper acknowledgment by each attorney:

"I (we) have no interest in the within certificate of stock, and within power of substitution dated is hereby cancelled."

and,

- (2) the registered owner shall have executed a separate detached assignment, and
- (3) the papers shall have been presented to the Exchange and determined to be in order.

RULE 203. (*Acknowledgments; affidavits*) Acknowledgments, affidavits, or depositions shall be executed before an officer having authority to take acknowledgments under the laws of the state in which such instruments are executed and shall bear the seal of the signing officer.

Any alteration or correction in an acknowledgment shall be properly noted by the signing officer.

RULE 204. (*Assignments of "rights"*) Rules 180 to 203 inclusive shall apply to assignments of registered warrants for rights to subscribe, provided that warrants assigned by a trustee, guardian, executor, administrator, conservator, assignee, receiver in bankruptcy or a corporation, shall be a delivery if permitted by the Exchange.

RULE 205. (*Called stock or registered bonds*) Certificates of stock or registered bonds which are called for redemption shall not be a delivery after the record date fixed by the corporation for the purpose of the drawing for redemption, or the date of the closing of transfer books therefor,

except when an entire issue is called for redemption and in respect of transactions in called securities dealt in specifically as such.

RULE 206. (*Called coupon bonds*) Coupon bonds which are called for redemption shall not be a delivery on and after the date of first publication of notice of call for redemption, except when an entire issue is called for redemption and except in respect of transactions in called bonds dealt in specifically as such.

RULE 207. (*Proper coupons, warrants*) Coupon bonds shall have securely attached proper coupons, warrants, etc., of the same serial numbers as the bonds. The money value of a coupon missing from a bond may be substituted by mutual consent of the parties to the contract.

RULE 208. (*Bonds registered as to principal*) Coupon bonds which have been registered as to principal shall be a delivery only if registered to bearer, or, while the transfer books are closed, only if accompanied by a proper assignment for each bond.

(*Bonds registered for voting purposes only*) Coupon bonds which have been "registered for voting purposes only" shall be a delivery only if such registration has been cancelled.

RULE 209. (*Endorsed bonds*) A coupon bond bearing an endorsement of a definite name of a person, firm, corporation, association, etc., in conjunction with words of condition, qualification, direction or restriction, not properly pertaining thereto as a security, shall not be a delivery unless sold specifically as an "endorsed bond."

This rule shall also apply to bonds with coupons bearing such endorsements.

RULE 210. (*"Released endorsed" bonds*) A coupon bond bearing an endorsement indicating that the bond was deposited in accordance with a governmental requirement pertaining to banking institutions or insurance companies shall not be a delivery. If released, with such release acknowledged before an officer authorized to take acknowledgments, it may be delivered if sold specifically as a "released endorsed bond."

RULE 211. (*Mutilated bonds*) A coupon bond which has become mutilated shall not be a delivery unless permitted by the Exchange.

RULE 212. (*Mutilated coupons*) A bond bearing a coupon which has been mutilated as to the bond number or signature or which has been cancelled in error shall not be a delivery unless the proper endorsement is made on the back of the coupon and signed by an officer or representative of the obligor.

In the case of coupons attached to domestic bonds, the endorsement shall be made by an officer of the obligor, and in the case of coupons at-

tached to foreign bonds, the endorsement shall be made either by an officer or a duly authorized American agent of the obligor.

RULE 213. (*Delivery of equivalent securities*) All contracts made in securities listed on the Exchange shall be subject to the condition that, unless otherwise specifically agreed between the parties, in the event that such securities become or are exchangeable for new or other securities under a plan or proposal relating to such securities, the Exchange may in its discretion direct that, upon admission to dealings of the new securities, settlement of such contracts, unless previously effected, may be made by delivery either of the securities contracted for or the equivalent in securities and cash or other property receivable under such plan or proposal.

RULE 214. (*Mechanically reproduced signatures*) (a) A member or member firm may assign securities registered in the name of such member or member firm, and may execute powers of substitution, by means of a mechanically reproduced facsimile signature, provided the member or member firm shall have executed and filed with the Exchange, in the form prescribed by it, an agreement with respect to the use of such facsimile signature and shall have complied with such other requirements as may be prescribed by the Exchange in connection with the use of facsimile signatures.

(b) A member corporation may assign securities registered in the name of such member corporation, and may execute powers of substitution, by means of a mechanically reproduced facsimile signature of an officer of such member corporation, provided the member corporation shall have (1) executed and filed with the Exchange, in the form prescribed by it, an agreement with respect to the use of such facsimile signature, (2) filed with the Exchange, in the form prescribed by it, a certified copy of resolutions of the Board of Directors of such member corporation authorizing the execution and filing with the Exchange of such agreement, and (3) complied with such other requirements as may be prescribed by the Exchange in connection with the use of facsimile signatures.

CHAPTER 24

PROCEDURE FOR RECORDING ORIGINAL ISSUANCE AND TRANSFER OF STOCK

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Procedure for Recording Original Issuance and Transfer of Stock

PROCEDURE IN TRANSFER DEPARTMENT OF LARGE CORPORATION

Variations in procedure. The methods used to record stock transfers vary from company to company. Some companies record entries by hand and have individuals make all calculations. Others have mechanized their system, and perform many of the processes by machine in the interest of speed and accuracy. Further mechanization is the trend. Some of the largest transfer departments and transfer agents have adapted integrated data processing (automation) techniques to stock transfer procedures. But whatever methods are employed, certain steps, essential to the effecting and recording of transfers, will be found in every system. These steps are outlined in the following paragraphs. Variations found in the systems of representative corporations will be explained. The objective of every system is a standardized practice that will expedite transfers and insure accuracy in recording.

Supervision of transfer department. The by-laws may indicate who shall have charge of the stock records of the corporation. Often these records are put in the custody of the secretary, and it then follows naturally that the stock transfer functions shall be under his supervision. In large corporations there is frequently enough transfer work to justify the establishment of a stock transfer department, under a stock transfer agent, an employee who is specially trained in transfer work. The transfer agent would report to the secretary. In other corporations the stock transfer department is placed under some officer other than the secretary, such as the treasurer, an assistant treasurer, or the controller.

Personnel of stock transfer department. The size of the stock transfer department varies greatly. It depends upon the number of stockholders, the activity of the stock, and whether the department also handles disbursement of dividends. A department may consist of three or four employees, or it may have a hundred. A large corporate transfer agent may employ several hundred people. Because the volume of transfer and dividend work is not constant, an attempt is made to maintain a group of employees trained to perform a variety of tasks. To these may be added temporary employees during rush periods.

The list in Form 759, below, shows the personnel and the division of work in a small, but typical, transfer department. This is a large company, with many subsidiaries, which are all wholly owned by the parent company. There is relatively little transfer activity in the shares of the parent company. Thus it is advisable to maintain a small permanent staff, and to augment it with temporary help at times of peak activity.

Form 759—Division of work among personnel of transfer department.

Stock Transfer Supervisor (Transfer Agent):

- Direct the department, and provide for efficient handling of all phases of work.
- Prepare and maintain procedures necessary for the operation of the department.
- Engage temporary employees when required for peak loads of work, such as disbursement of dividends, issuance of proxies or notices of stockholders' meetings.
- Conduct all correspondence pertaining to holdings of stock, issuance or transfer of stock, dividends, and similar subjects.
- Sign stock certificates as transfer agent.
- Process legal or irregular transfers in conjunction with counsel.
- Requisition and maintain supply of stock certificates in accordance with New York Stock Exchange listing requirements.
- Insure compliance with all applicable Federal and State Laws, and with stock exchange requirements, in conduct of the work of the department.
- Assist Inspectors of Elections at stockholders' meetings.

Assistant Stock Transfer Supervisor (Transfer Agent):

- Supervise all work performed by other members of department, including temporary employees.
- Handle research in connection with numerous inquiries about stock, accounts, dividends, changes of address, etc.
- Maintain controls on shares issued, accounts, and proxies for annual meeting.
- Maintain control of unused certificates and receipts.
- Sign stock certificates as Transfer Agent.
- Enter all stop notations and stop releases in stockholders' accounts.
- Advise Co-Transfer Agent and Registrar of all stops and stop releases, and in turn

execute all stop notations received from Co-Transfer Agent.
Prepare Federal and State tax returns on dividends paid and shares held.
Assist Inspectors of Election at stockholders' meetings.

Window Clerk:

Examine and accept certificates of stock presented for transfer.
Issue window tickets.
Prepare accepted regular items for making up of new certificates and transfer journal by typist.
Refer irregular or legal items to Transfer Agent.
Check and verify typist's work and prove debits and credits on journal sheet with old and new certificates.
Cancel old certificates and prepare new ones for signing by Transfer Agent.
Check certificates for delivery to Registrar and, when returned, deliver new stock to persons entitled thereto.
Maintain visible stop transfer index.
Process legal transfers after return from counsel and approval by Transfer Agent.
Purchase and affix stock transfer stamps on certificates received from out of town sources.
Maintain check on certified mail return receipts.
File stock receipts in numerical order and store cancelled stock certificates in archives for ready reference.

Senior Clerk:

Prepare daily record of transfers for posting.
Post transfers, and changes of address, to stock ledger maintained by Assistant Department Supervisor. Maintain transfer journal.
Send daily notice of changes in stock ledger to appropriate section to have changes reflected in addressograph stencil file.
Prepare dividend checks and enclose signed checks for mailing.
Prepare record of dividend payments, for Federal and State tax returns.
Check and process all new accounts. Arrange for mailing to new stockholders letter of welcome from president of the company.

Stenographer-Clerk:

Take and transcribe dictation; type letters, statements, reports, payrolls, records, etc.
Maintain general and confidential files.
Enter changes of address on stock ledger cards.
Type daily record of transfers on transfer journal.
Maintain and order supplies.
Perform a variety of other clerical duties.

Presentation of certificate of stock for transfer. Most certificates are presented at the transfer window or counter in person by the purchasers or by brokers' messengers. (In some cities, such as New York, in which exchanges are located, certificates from brokers and banks are usually presented through a stock clearing corporation.) The window clerks are familiar with transfer requirements and are specially trained to examine quickly and thoroughly the documents submitted. They examine the instruments to see: (1) that the assignment is properly executed; (2) that the signature on the assignment

corresponds with the name on the face of the certificate;¹ (3) that the signature is witnessed and is guaranteed by a recognized officer of a bank or trust company or by a member of the stock exchange; (4) that the full number of shares has been transferred by the assignment;² (5) that, if the power of attorney has been filled in with a name other than that of the corporation or its transfer officer, a proper power of substitution is annexed; (6) that the name and address of the transferee is properly indicated; (7) that the date of the assignment is later than the date of the certificate of stock; (8)

CONSOLIDATED DELIVERY STUB N^o 78544 Window ☐ Mail ☐ Clearing Corp. ☐ <i>Attach to</i> _____ Company CERTIFICATES OF COMMON STOCK: SET FORTH BELOW Shares Received _____ Rec'd from _____ _____ _____ _____ _____	POWER COMPANY N^o 78544 <i>Received from</i> _____ Company NEW YORK 4, N. Y. CERTIFICATES OF COMMON STOCK AS FOLLOWS Number of Shares _____ Signed _____ Per _____ Address _____ Date _____ (Stock delivered only on surrender of this receipt, properly filled in and signed in ink)
--	--

Form 760—Window ticket for “regular transfer.”

that the proper transfer tax stamps have been attached; (9) that the bill of sale contains transfer tax stamps or a notation that the tax has been paid (see p. 1030), and also bears a date later than the date when the certificate of stock was issued; and (10) that all additional docu-

¹ See Rule 29b, page 999, for acceptance of a guaranty where the signature does not correspond exactly with the name on the face of the certificate.

² Where only part of the shares are assigned to another, the assignment indicates that the balance of the shares are assigned to the original holder.

ments required to effect the particular transfer are submitted and are in order.

If the certificate presented appears to be in order, the window clerk fills out a window ticket like that in Form 760, from a consecutively numbered group. The right-hand portion of the ticket is given as a receipt to the person presenting the certificate for transfer. The left-hand portion, or stub, is attached to the certificate.

Filling in the window ticket. The window clerk fills in the ticket stub to show the number of shares of stock presented for transfer, and the name of the broker or other person presenting them for transfer. Some corporations make it a point not to fill in any information on the right-hand (the receipt) portion of the window ticket; instead, they require that the number of shares deliverable and the person to whom they are to be delivered be filled in at the time the ticket is presented for delivery of the new certificate of stock. This eliminates the possibility of delivering the new certificate of stock to the wrong person if the ticket should be lost after it was issued at the window. A person finding the ticket cannot obtain delivery of the stock certificate, for he will be unable to identify the shares called for by the window ticket. Other corporations, however, require the person presenting the certificates to fill in the number of shares submitted for transfer, in his own handwriting, so that no question may arise as to the number of shares to be delivered.

As a protection against presentation of a false window receipt, one corporation stamps haphazardly across the perforation dividing the two parts of the window ticket, a box containing the initials of someone in the transfer department. When the portion of the window ticket which has been given out as a receipt is presented for delivery of the new certificate of stock, this stamped box is matched up against the other part of the window ticket, which has been retained in the transfer department.

Stamping time of presentation upon window ticket. In many transfer departments the date and time of receiving the old certificate is written or time stamped on both parts of the window ticket. Others indicate merely the date and whether the certificate was presented before or after noon. The time for delivery of certificates is fixed as

a matter of practice by each transfer department. Under rules of the New York Stock Exchange, deliveries made after 12:00 noon are considered as having been made on the following day.

Window tickets for various classes of stock. If a corporation has several classes of stock in which transfers are active, each class of stock may have its own special window ticket, differing from the others in color or lettering. Some distinguishing initial on the ticket may also indicate what class of stock is to be delivered upon presentation of the ticket. Inactive stock of various classes has a "miscellaneous" ticket with its own distinguishing color.

Machine window tickets in triplicate. Most transfer departments use the simple window ticket shown in Form 760. The transfer department of a very large company, however, uses a window ticket machine. The tickets are arranged in the machine in triplicate and are filled out by the window clerk before being removed from the machine. One copy is attached to the stock certificate. One is given to the person presenting the certificate for transfer, to serve as a receipt and presented when he obtains the new certificate. One copy accompanies any irregular transfer which is referred to the legal department.

Irregular or "legal" transfers.³ Where presentation is made of certificates of stock issued in the name of a corporation, association, guardian, trustee, decedent, and the like, supporting documents are required to effect the transfer. Such transfers are known as irregular or "legal" transfers, and some person other than the window clerk is generally required to pass on the documents necessary to effect the transfer. In some organizations, irregular transfers are turned over to the head of the transfer department; in others, they are submitted to counsel for the corporation. The window clerk accepts the certificate of stock, subject to approval, and instead of issuing a receipt as indicated in Form 760, a receipt such as is shown in Form 761 is issued.⁴ Many transfer departments use the ordinary form of receipt, as in the case of a regular transfer, but stamp

³ Such transfers are sometimes designated as "fiduciary transfers."

⁴ The ordinary receipt shown in Form 760 is sometimes further distinguished from the receipt indicated in Form 761 by the use of a different color.

on both parts of the receipt some notation of the irregularity, such as, "Accepted subject to examination and approval."

	No.	DATE	_____ CORPORATION TRANSFER DEPARTMENT (Room _____) 101 _____ Street, New York City No. _____
	NEW CERTIFICATES		
	RECEIVED FROM		
		SHARES	
AMOUNT SHARES		DESCRIPTION	RECEIVED FROM _____ CORPORATION THE ABOVE MENTIONED SHARES TOGETHER WITH PAPERS ATTACHED WHICH WERE LEFT SUBJECT TO EXAMINATION. SIGNED..... PER..... NEW YORK, ... 19..... STOCK DELIVERED ONLY ON RETURN OF THIS SLIP PROPERLY RECEIPTED.

Form 761—Window ticket for "irregular transfer."

Form 762—Letter indicating additional requirements for transfer.

..... CORPORATION
 STREET
, ...

STOCK TRANSFER DIVISION

Re:

With reference to your recent request to transfer shares of Corporation common stock, registered as above-captioned, we wish to advise that before transfer may be effected, it will be necessary that we be furnished with the requirements as checked on the reverse of this letter.

Yours very truly,

.....
 Transfer Agent

A letter, as illustrated in Form 762, may be forwarded to the transferor of the stock after the supporting documents have been examined by the head of the transfer department or by counsel; or the window clerk may immediately fill out a sheet as shown in Form 763, indicating additional documents which must be furnished before a transfer of the stock will be effected and other requirements for transfer, and give it to the person presenting the stock for transfer.

REQUIREMENTS

() 1. Stock Certificates endorsed by.....in representative capacity.

() 2. Copy of { Power of Attorney }
Trust Instrument } guaranteed as of recent date by a New York Stock Exchange firm, a New York bank
or trust company, or a bank or trust company having a New York correspondent, to be a true copy of the original
and in full force and effect.

() 3. Copy of will of....., certified by the proper court officer.

() 4. Certificate of the proper court officer, bearing recent date, evidencing the appointment and present authority of.....

() 5. New York Waiver.

() 6. Waiver or Consent of tax authorities of.....

() 7. New York statutory form of affidavit of Executor(s) or Administrator(s) in regard to the domicile of the decedent at the time of his death. (Form enclosed)

() 8. Affidavit of Executor(s) or Administrator(s) showing payment of or provision for all taxes, funeral and administration expenses, debts, legacies, and all other claims against the estate.

() 9. Copy of Court Order, certified by the proper Court officer, authorizing transfer or sale.

() 10. { Death Certificate of }
Birth Certificate of }

() 11. Copy of { Resolution
By-Law } showing the authority of the officers who have executed the assignments of the stock certificates to make the transfer, certified to be in full force and effect as of recent date by a proper corporate officer other than the officers who have executed the assignments.

() 12. Copy of Resolution showing the authority of the officers who have executed the assignments of the stock certificates to make the transfer or to affix the corporate seal for the purpose of transferring stock, certified to be in full force and effect as of recent date by proper corporate officers other than the officers who have executed the assignments.

() 13. Certificate of proper corporate officer(s), other than the officers who have executed the assignments, bearing recent date, evidencing that the officers who have executed the assignments are duly elected and still hold office, or were duly elected and held office at the time of the assignment of the stock certificates; or list of officers so certified.

() 14. Certificate of merger or consolidation or of change of name, evidencing.....

() 15. Certificate by the fiduciary, setting forth that the transfer of the stock certificates to its nominee is being made solely for the purpose of effecting a sale of the shares represented thereby.

() 16. The transfer should be made into the name.....
.....
Instead of as requested, and the assignments of the stock certificates should be changed accordingly, and the alteration guaranteed.

() 17. Remit \$.....to cover New York State and Federal transfer tax stamps, or remit \$.....
and a certificate of the transferor as follows:

"The undersigned certifies that the transfer of the within shares does not constitute a sale. Tax is paid at the lower rate."
or
"This is to certify that the transfer of the within shares represents a sale in which the selling price was less than \$20.00 per share."

() 18. Signature of transferor should be guaranteed by a bank (other than a savings bank) or trust company located in or having a correspondent in the City of New York or by a New York Stock Exchange Firm.

() 19. Guarantee that the registered holder is a partnership and that the party signing is one of the partners.

() 20. Guarantee of endorsement by bank or trust company located in or having a correspondent in New York City or by a New York Stock Exchange Firm.

() 21. Guarantee that....., the registered holder
and.....is one and the same person.

Form 763—List of requirements for transfer. (Reverse side of Form 762.)

.....Corporation LEGAL TRANSFER					
Receipt No.		File Under:			
Date Received.					
Submitted by		Cross References			
.....					
.....					
Certificates Received:					
Certificate Numbers	Number of Shares	Now in name of	To be transferred to		
DOCUMENTS SUBMITTED <table style="width: 100%; border: none;"> <tr> <td style="width: 50%; vertical-align: top; padding: 2px;"> ☐ 1. Certified copy of Will. ☐ 2. Certified copy of Trust Instrument. ☐ 3. Certificate of appointment of dated..... ☐ 4. Power of Attorney. ☐ 5. Affidavit <i>re</i> domicile. ☐ 6. Affidavit <i>re</i> payment of debts. ☐ 7. New York Waiver for.....shares. ☐ 8. Waiver. ☐ 9. Court Order..... ☐ 10. Certificate <i>re</i> proposed transfer. </td> <td style="width: 50%; vertical-align: top; padding: 2px;"> ☐ 11. Birth Certificate of..... ☐ 12. Death Certificate of..... ☐ 13. Resolutions (By-Laws). ☐ 14. Certificate <i>re</i> officers. ☐ 15. Certificate <i>re</i> merger, consolidation, or change of name. ☐ 16. Certificate by fiduciary <i>re</i> transfer to nominee. ☐ 17. ☐ 18. ☐ 19. ☐ 20. </td> </tr> </table>				☐ 1. Certified copy of Will. ☐ 2. Certified copy of Trust Instrument. ☐ 3. Certificate of appointment of dated..... ☐ 4. Power of Attorney. ☐ 5. Affidavit <i>re</i> domicile. ☐ 6. Affidavit <i>re</i> payment of debts. ☐ 7. New York Waiver for.....shares. ☐ 8. Waiver. ☐ 9. Court Order..... ☐ 10. Certificate <i>re</i> proposed transfer.	☐ 11. Birth Certificate of..... ☐ 12. Death Certificate of..... ☐ 13. Resolutions (By-Laws). ☐ 14. Certificate <i>re</i> officers. ☐ 15. Certificate <i>re</i> merger, consolidation, or change of name. ☐ 16. Certificate by fiduciary <i>re</i> transfer to nominee. ☐ 17. ☐ 18. ☐ 19. ☐ 20.
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Transfer Tax Required. ☐ Federal \$. ☐ N. Y. State \$.		Submitted to Counsel..... Approved Rejected			
Documents Returned ☐ ☐ ☐		Transfer Approved. Transfer Agent, Date Approved			
Acknowledgment of receipt filed File Clerk					

Form 764—Record of documents on “irregular transfer.”

The documents submitted to effect the transfer are checked off on the form. When the transfer has been approved, it is signed by the transfer agent in the lower right-hand corner, and the form, with the documents attached, is placed in the document file. Documents are sometimes returned to the person who presented them,

after the transfer agent or counsel is satisfied as to the propriety of the transfer. A receipt for documents returned, as shown in Form 765, is required to be signed, and the receipt is placed in the document file.

Form 765—Receipt for documents returned after examination.

Received from Corporation, Stock Transfer Department following documents:

Certified copy of Will of;
 Certified copy of Trust Agreement dated, 19..., between, Trustee, and;
 Corporation Common Stock Certificate No., for shares.

By
 Per
 Date, 19...

Affidavit concerning domicile. Many transfer agents and transfer departments require the execution of an affidavit of domicile before transferring stock for a decedent's estate. Form 766 is the type commonly used for this purpose.

Transfer tax stamps. A certificate presented for transfer is accompanied by federal and state transfer tax stamps.⁵ Where a certificate is registered in the name of an individual, the stamps are generally pasted on the stock certificate itself. Street name certificates issued in the name of a broker, however, may be transferred from hand to hand many times before the certificate is actually presented to the transfer agent for recording. To avoid having the certificate virtually covered with transfer stamps, the stamps may be pasted on the broker's bill of sale, or the bill may be rubber stamped: "Federal Tax Due Paid Through Stock Clearing Corporation. New York Tax Exempt." or "New York-Federal Tax Due Paid Through Stock Clearing Corporation," followed by the date, a facsimile of the

⁵ As a matter of convenience to stockholders, a supply of stamps is sometimes kept on hand at the window clerk's desk, and sold to stockholders who have not attached a sufficient amount of stamps to their certificate.

broker's signature, and the name of his firm. In certain cases the certificates of stock themselves are so stamped. The window clerk must see that the date on the bill of sale is subsequent to the date of

Form 766—Affidavit as to domicile.

IN RE: Estate of

STATE OF }
COUNTY OF } ss:

....., being duly sworn says: That is
..... (state relationship or that affiant is executor, adminis-
trator, or attorney) of the above named decedent.

That the said decedent died at, in the State of..
..... on the day of, 19..., and for over two
years prior to death was resident of, in the
State of to the personal knowledge of deponent.

That all of the certificates of stock submitted herewith for transfer were
physically located in the state of decedent's domicile at the time of his death.

.....
(Deponent)

Subscribed and sworn to me this day of, 19...
.....
Notary Public

execution of the assignment; that is, the bill must cover a sale which
took place after the execution of the assignment. If the bill and
stamps are in order, the window clerk generally fastens the bill
to the stock certificate.

One bill of sale, properly stamped, may cover several certificates.
In such cases, the bill of sale is fastened to one certificate, and the
other certificates are marked to show the number of the certificate
to which the bill of sale is attached.

To facilitate the work of the window clerk in checking the amount
of transfer tax stamps required, some companies post a chart in front
of the window clerk's desk, showing the exact amount of the tax
due for each number of shares which may be presented. When a
certificate representing a certain number of shares is presented, the
clerk simply checks the amount of the stamps attached to the cer-

tificate against the amount appearing opposite that number of shares on the chart. No such check is necessary on brokers' transfers that are marked as tax paid.

Signature guaranty. Many banks and trust companies issue

TYPE B-TO BE USED ONLY IF ATTORNEY IS TO BE AUTHORIZED TO SIGN HIS NAME IN CONJUNCTION WITH AN IMPRINT OF THE FIRM NAME.

FIRM NAME

NAME OF ATTORNEY UNDER POWER IN FORM PRESCRIBED BY AND FILED WITH NEW YORK STOCK EXCHANGE	SIGNATURE

ON LEFT SIDE OF CARD—TYPEWRITE NAME OF ATTORNEY.
ON RIGHT SIDE OF CARD—IN SPACE OPPOSITE NAME, ON FINE LINE, INSERT SIGNATURE OF ATTORNEY TO BE AUTHORIZED UNDER POWER FILED WITH THE EXCHANGE.
ON BACK OF CARD —IMPRESS RUBBER STAMP, CONTAINING FIRM NAME, THAT WILL BE USED IN CONJUNCTION WITH SIGNATURES.

IMPORTANT ➤ AS SIGNATURES ARE TO BE REPRODUCED, ALL SPECIMEN SIGNATURES MUST BE IN BLACK INK.

884-B-11-59

Form 767—Signature guaranty card.

signature books containing facsimile signatures of the officers authorized to guarantee signatures in their behalf. These books are kept in an alphabetical file for ready reference in checking the signature guaranties. The various transfer offices are notified of any changes in authorization by the respective banks and trust companies.

The New York Stock Exchange provides a signature card service to transfer agents of all listed securities. The exchange furnishes photostatic facsimiles of the signature cards filed by members with the Exchange, as well as other signature data. Advices are sent to

transfer agents as new signatures are authorized or as authorizations are terminated. Different types of signature cards are used to reflect different kinds of authorizations. For example, Form 767 shows the signature card used in cases in which the attorney is authorized to sign his name in conjunction with an imprint of the firm name.

Date of letter advising of loss.....		
From whom received		
Address.....		
.....		
Telephone No.		
Substitute Certificate issued —		
Date.....19.....		No.....
Certificate No.	Name of Stockholder	No. of Shares

Form 768—Stop transfer card.

The window clerk is generally familiar with the signatures of the various bank and trust company officials authorized to sign, and of the members of the stock exchange. He does not have to resort to the signature file each time a certificate is presented. The examination of signatures and the detection of forgeries is a part of the window clerk's training. The signature file is, however, always at his disposal and is referred to in case of doubt.

Stop transfer records. When a certificate of stock has been reported as lost, when the corporation has been notified that a person in whose name stock is registered has died, or when an order to stop the transfer of stock for some other reason has been received, a notation is made on the stop transfer records. These records may be kept either numerically or alphabetically. In a numerical stop transfer record, the certificates against which stop orders are effective

are listed in numerical order according to the certificate of stock. In an alphabetical list, the record of stop orders is kept according to the names of the persons registered as owners of the stock. Some corporations keep both a numerical and an alphabetical list as a double check on stop transfers.

STOP TRANSFER			
NAME AND ADDRESS OF STOCKHOLDER			
DATE OF NOTICE	AUTHORITY	NUMBER OF CERTIFICATE	NUMBER OF SHARES
STOP REMOVED		AUTHORITY	
DUPLICATE CERTIFICATE ISSUED			
NUMBER OF CERTIFICATE	NUMBER OF SHARES	IN THE NAME OF	AUTHORITY
REMARKS			

Form 769—Envelope stop transfer record.

One corporation fills out a card as shown in Form 768, immediately upon receipt of a stop transfer notice. The lower part of the card, showing the certificate number, the name of the stockholder, and the number of shares, is visible in the file, and the clerk examining the file to see whether a stop transfer notice has been placed against

a particular certificate can check it at a glance. An alphabetical cross index of the stop transfer record is kept as a recheck.

Another corporation maintains quadruplicate stop transfer records. The first record is a visible alphabetical index, kept on the desk of the window clerk, showing the name of the stockholder, the number of his certificate of stock, and the number of shares which the certificate represents. This record is examined by the window clerk immediately after examination of the stock certificate presented for transfer. The second record is exactly like the first, but it is kept and examined by the person who checks the transfer sheets. The third record is a visible numerical index, showing the number of the stock certificate, the name of the person who owns the certificate, and the number of shares which the certificate represents; it is kept and examined by the person who arranges the new stock certificates in numerical order just before they are sent over to the registrar for counter-signature. The fourth record is a colored envelope bearing the history of the stop transfer as shown in Form 769. The ledger card of the stockholder is placed in this envelope and returned to the ledger account file. The envelope will warn against any attempt to record the transfer on the ledger card.

..... CORPORATION		
Date of Transfer 19...		
Report Number		
To: Transfer Section		
From: Bookkeeping Section		
Subject: Release of New Common Stock Certificates		
You may release certificates issued as the result of transfers effected on the above-mentioned date with the exception of new certificates issued for the following debit certificates against which stop orders are recorded:		
Certificate No.	No. of Shares	Registered in Name of
.....		
.....		
.....		
.....		
Chief Bookkeeper		

Where a corporation has many stop transfers, it may keep separate stop records for each class of stock. Decedents' stop transfers are also sometimes kept separately from stop transfers on certificates of stock which have been reported as lost.

A sheet such as shown in Form 770 is sometimes used to record interdepartmental notices as to stop orders which are outstanding on certificates issued. These notices are later filed away with the working papers for that particular day's transfers.

Notices and acknowledgments upon receipt of stop transfer order. In addition to making up the stock transfer records as described in the preceding paragraph, the transfer department must give notice of the stop transfer order to the registrar, to the co-registrar, to the co-transfer agent, and to any person interested in the stock. The transfer department also acknowledges receipt of the stop transfer order from the stockholder. An active transfer department which receives many stop orders keeps on file form letters to acknowledge receipt of the stop transfer notice and to notify the various departments. These letters are printed in groups of three. One letter, illustrated in Form 771, is sent to the registrar; a second letter, illustrated in Form 772, is sent to the stockholder, urging him to make an effort to find the stock in order to avoid the expense of

Form 771—Notice to registrar to stop transfer.

STOCK TRANSFER DIVISION

..... Bank, Registrar
 Street

 Gentlemen:

Attention of Mr., Cashier

Until further notice, please refuse transfer on stock certificates of.....
 Corporation as listed below:

Certificate No.	No. of Shares	Class	Registered in Name of
.....			
.....			
.....			

Your acknowledgment of receipt of this notice will be appreciated.

Very truly yours,

.....
 Transfer Agent

issuing a duplicate; and a third letter, shown in Form 773, is kept on file in the transfer department.

For a detailed explanation of the procedure involved in the issuance of a new certificate of stock to replace a certificate which has been lost, destroyed, or stolen, see Chapter 25.

Removal of stop transfer order. In many instances, stockholders who have reported their stock as lost and have entered a stop trans-

Form 772—Letter to stockholder urging search for lost certificate.

STOCK TRANSFER DIVISION

In accordance with your letter of, ..., we have placed a stop transfer on stock certificates of the Corporation as listed below:

Certificate No.	No. of Shares	Class	Registered in Name of
.....			
.....			
.....			

Experience has taught us that certificates reported as lost, mislaid, or stolen often come to light after a more thorough search by the stockholder, and the expense incidental to the filing of affidavits of loss and indemnity bonds is saved by the stockholder. For this reason, our Company has established the practice of requiring the lapse of a three months' interval from the date of notice of loss of certificate before forwarding to the stockholder the following forms, which must be executed before the replacing certificate may be issued: (1) affidavit of loss; (2) indemnity bond (open penalty form).

Accordingly, we have marked our file forward three months, at which time, unless we hear from you to the contrary, the above-mentioned forms will be forwarded to you, together with instructions as to their execution.

If the certificates are recovered, please give us immediate notice, so that the stop transfer order may be cancelled.

Very truly yours,

.....
Transfer Agent

Form 773—Advice of stop transfer filed in transfer department.

ADVICE OF STOP TRANSFER

Certificate No.	No. of Shares	Class	Registered in Name of
.....			
.....			
.....			

Acknowledged by:
Registrar, ..., 19....
Acknowledged to:

fer order against it, find the stock certificate after receipt of a letter such as is illustrated in Form 772, urging a thorough search. The stockholder will, of course, desire to have the stop order removed, and notice of the removal of the order must be sent out by the transfer department to the persons who were originally notified of the stop order. A series of form letters as illustrated in Forms 774 - 776 inclusive, may be used.

The certificate number and the name of the stockholder will, of course be removed from the various stop transfer records.

Form 774—Notice to registrar to cancel stop transfer instructions.

STOCK TRANSFER DIVISION

..... Bank, Registrar
, ... Street
, ...
 Gentlemen:

Attention of Mr., Cashier

Please cancel our stop transfer instructions of, covering stock certificates of the Corporation as listed below:

Certificate No.	No. of Shares	Class	Registered in Name of
.....			
.....			
.....			

Your acknowledgment of receipt of this notice will be appreciated.

Very truly yours,

.....
 Transfer Agent

Form 775—Notice to stockholder of cancellation of stop transfer.

STOCK TRANSFER DIVISION

In accordance with your letter of, we have today cancelled the stop transfer on Corporation stock certificates as listed below:

Certificate No.	No. of Shares	Class	Registered in Name of
.....			
.....			
.....			

Very truly yours,

.....
 Transfer Agent

Form 776—Memorandum of removal of stop transfer filed in transfer department.

REMOVAL OF STOP TRANSFER			
Certificate No.	No. of Shares	Class	Registered in Name of
.....			
.....			
.....			

Acknowledged by
Registrar, ... , 19....
Advice of Removal sent to:
.....

Rechecking of certificate of stock presented for transfer. After the stop transfer record has been examined, and before the process of issuing a new certificate of stock and recording the transfer is begun, the certificate presented for transfer is rechecked. A clerk examines the assignment to see that it is properly executed, and rubber stamps in the name of the official authorized to effect the transfer on the books of the corporation. He also rechecks the payment of transfer taxes and examines the stock ledger to see whether stock for the number of shares designated in the certificate presented for transfer actually stands in the name of the transferor on the books of the corporation. The clerk also fastens securely to the back of the stock certificate the broker's bill of sale, which contains the evidence of payment of the stock transfer taxes. When the rechecking process is complete, the clerk puts his initials at the bottom of the stock certificate.

Cancellation of old certificates of stock. The old certificates of stock presented for transfer are run through a cancelling machine. This machine perforates through the signature of the transfer agent on the stock certificate the word "Cancelled," together with the date of cancellation. Where the signatures of the officers of the corporation are facsimile and are not valid unless the transfer agent's signature is also in effect, no perforations need be made through the officers' signatures; the perforation through the transfer agent's signature is sufficient to invalidate the certificate.

In some transfer departments, the old certificates of stock are cancelled before new certificates of stock are drawn and transfer

sheets made up; in others, they are not cancelled until the new and the old certificates are ready to be delivered to the registrar.

Allotment of new certificates of stock. The assignment on a certificate of stock presented for transfer may indicate that all of the shares which it represents are to be transferred to one individual, or distributed among two or more individuals, or that only a part of the shares are to be transferred. An allotment clerk examines each old certificate of stock and places with it one or more new blank certificates of stock, of the proper class and denomination, to be used in completing the transfer.

Blank certificates of stock on hand. Most corporations keep on hand in the stock transfer department a supply of new blank certificates of stock that is sufficient only for their immediate needs. A reserve supply is maintained in the vaults of the corporation. An additional supply of stock certificates is sometimes stored with the printer.

Certificates for 100 shares and those for less than 100 shares are kept in separate lots. Each lot may have a different color or an individual designating letter. For example, each number of a certificate for 100 shares may be preceded by the letter A, whereas each number of a certificate for less than 100 shares may be preceded by the letter B.

Control of blank certificates of stock. Blank certificates of stock are generally under the personal control of the officer or other individual in charge of the transfer department, since the loss of a single certificate of stock may involve considerable inconvenience and expense to the corporation. Where official control of the transfer department rests with some person other than the one having actual control, it is generally the person who is in official charge of the department upon whom the ultimate responsibility for blank certificates of stock rests. As certificates are needed by the department, they must be requisitioned from this person. One corporation uses the type of requisition slip shown in Form 777. The transfer department estimates, each week, the number of certificates that will be required for the issuance of new certificates of stock during that week, and makes the necessary requisition.

Form 777—Requisition slip for new certificates of stock.

Received from Mr., Secretary of
Corporation, the following certificates of stock:

Quantity of Certificates	Class of Stock	Denomination	Certificate No.	
			From	To
250	Common	100 shares	C-17501	C-17750
300	Preferred	Less than 100	P-24301	P-24600
.....				
Transfer Agent				

Records of new stock certificates issued. The allotment clerk who counts out the number of new certificates that must be issued in place of old certificates of stock presented for transfer, prepares a list (see Form 778) showing the number of certificates issued during the day. Each day's work is given a number, as, "Report No. 3," which appears on each transfer sheet used during that day. As a check on the allotment clerk, the bookkeeper makes a detailed report from the transfer sheets, showing the number of 100-share certificates and certificates for less than 100 shares used on each transfer sheet, with a special column provided for voided certificates (see Form 779). A copy of this report accompanies the new certificates of stock when they are sent to the registrar for counter-signature. Another check is provided by making an actual physical count on the adding machine, before the certificates are signed by the transfer agent, of the number of shares represented by the new certificates issued, divided as to 100-share certificates and certificates for less than 100 shares. The total arrived at from the computation made from the certificates themselves must equal the figure recorded on the transfer sheets as the total number of shares issued. A control account of stock certificates received, used, and on hand, as shown in Form 780, is maintained by the head of the transfer department.

Typing the new certificates of stock. In most transfer departments, before the transfer sheets are made up, a stock issue clerk fills in on a typewriter, on the new certificates of stock, the name of the transferee and the number of shares to be issued to him. This typewriter is generally equipped with special type and an

_____ CORPORATION RECORD OF STOCK CERTIFICATES USED DATE _____ REPORT NO. _____ CLASS OF STOCK _____			
100 SHARE CERTIFICATES		FRACTIONAL CERTIFICATES	
SERIAL NO.	NUMBER OF CERTIFICATES	SERIAL NO.	NUMBER OF CERTIFICATES
CERTIFICATES USED. LESS CERT. SPOILED CERT. ISSUED			
PREPARED BY _____		CHECKED BY _____	

Form 778—Allotment clerk's report of certificates issued.

HEAD BOOKKEEPER'S REPORT No. _____ CERTIFICATES USED * COMMON Date _____									
Sheet	Issued		Spoiled		Sheet	Issued		Spoiled	
No.	100s	Frac.	100s	Frac.	No.	100s	Frac.	100s	Frac.
1					26				
2					27				
3					28				
4					29				
21					46				
22					47				
23					48				
24					49				
25					50				

Issued
Void

SHARES TRANSFERRED

Form 779—Bookkeeper's report of certificates issued.

..... CORPORATION

CONTROL OF STOCK CERTIFICATES

MONTH.....19..

DATE	CLASS OF STOCK			DENOMINATION			RECEIVED FROM PRINTER			CERTIFICATES USED			TOTAL ON HAND	CERTIFICATES USED		TOTAL SPOILED CERTIFICATES	BALANCE ON HAND END OF DAY	REPORT NO.
	ON HAND			CERTIFICATE NUMBERS			CERTIFICATE NUMBERS			INCLUDING SPOILED CERT.		TOTAL						
	FROM	TO	TOTAL	FROM	TO	TOTAL	FROM	TO	TOTAL									
1																		
2																		
3																		
4																		
5																		
6																		
7																		
8																		
9																		
10																		
23																		
24																		
25																		
26																		
27																		
28																		
29																		
30																		
31																		
TOTAL FOR MONTH																		

AUDITED.....

APPROVED.....

TRANSFER AGENT.....

Form 780—Control account of stock certificates.

indelible ribbon to guard against alteration. The allotment clerk has already placed behind each old certificate the new blank certificates of stock required to effect the particular transfer, and the information to be typed on the new certificate is obtained by examining the assignment on the corresponding old certificate. In some organizations, in order to insure similarity in the name of the new stockholder as it appears on the new certificate and on the transfer record, the name is typed in on both by the same operation. Error may also be avoided, however, by having one operator type the new certificate from the old certificate, another operator type the transfer sheet from the same old certificate, and a third clerk check the work of both operators.

The stock issue clerk checks the serial numbers of new certificates to see that they are in the correct sequence.

Inserting names of brokers on stock certificates by means of stencils. A corporation whose stock is generally handled by the same brokers keeps in a separate alphabetical file stencils bearing the names of these active brokers. When a certificate is to be issued in the name of one of these brokers, the name is inserted on the certificate of stock, not by means of a typewriter, but by making an impress of the stencil. In this way, any possibility of error in the spelling of a broker's name is eliminated, and it is not necessary to check the name entered on the new stock certificate against the assignment on the old certificate, as is usually the case. Inasmuch as no erasures are permitted on certificates of stock, and errors require the voiding of certificates, hundreds of blank certificates may be saved in the course of a year by the use of the stencils.

Correction of name on new certificate of stock issued. In presenting certificates of stock for transfer, brokers sometimes make errors in the name of the transferee to whom the new stock certificate is to be issued. For example, an initial may have been designated incorrectly, or a name may have been misspelled. As a simple means of correcting such errors, some transfer departments issue new certificates in the correct name, merely upon the signing by the broker of a letter of indemnification as shown in Form 781. Some corporations also carry insurance to cover any loss which may occur by

reason of the issuance of such corrected certificates. The incorrect certificate must, of course, be marked "Void," and a proper notation must be made in the transfer record to show the cancellation of the first certificate and the issuance of a second new certificate.

Form 781—Broker's letter of indemnification upon issuance of certificate in corrected name.

..... Corporation
 Transfer Agent
 Street
, ...

Dear Sir:

At our request, you transferred, on, 19...., certificates for shares of stock of Corporation, and issued certificates in transfer thereof, represented by Certificate No., in the name of This transfer to was erroneously requested by us, and we hereby certify that never purchased, owned, or had any interest in said stock.

In consideration of your issuance of certificates in the name of, the rightful owner, we agree for ourselves, our successors, assigns, heirs, executors, and administrators, to hold and save you harmless from any loss, liability, or claim that may arise by reason of your issuing a certificate to the said, residing at Street, ..., ...

Filling in number of shares on new stock certificate. In certificates for exactly 100 shares, the number of shares is generally engraved on the body of the certificate of stock, as well as in each corner and in the margin. Certificates for less than 100 shares are issued in a separate series, in blank, and a notation "certificate for less than 100 shares" appears in several places on the certificate. The number of shares for which such certificates are issued is typed out on the body of the certificate, and the figures are typed in a blank space in the upper right-hand corner of the certificate. The number of shares is also designated by a perforation through a table of numbers which appears in the right-hand margin of the stock certificate.

Some companies use a share group arrangement of filing addressograph plates by the number of shares owned by a stockholder. Thus the plates for all stockholders each of whom owns but one share

will be filed in one group. Plates for stockholders each of whom owns two shares will be filed in another group, and so on. These companies, as do some others, have the new certificates pre-printed and pre-punched to show the number of shares represented by the certificate. In such a case it is necessary to impress on the certificate only the name of the stockholder.

Dating new certificates of stock. After the number of shares has been filled in on certificates for less than 100 shares, all the new certificates of stock are dated. The date on the certificate of stock is typewritten by some corporations and rubber-stamped by others. In some transfer departments, stock certificates are not dated until they are ready to be sent to the registrar for counter-signature.

Typing certificates of stock at same time as transfer sheet. In some transfer departments, the certificates of stock and the transfer sheets described in the following paragraph are filled in at the same time to avoid discrepancies between the certificates and the transfer sheets. The certificate of stock is simply slipped into the machine in front of the transfer sheet, after all the details, except the name of the transferee and the number of shares to be issued, have been filled out on the transfer sheet. The first copy of the transfer sheet, in this case, will not show either the name of the transferee or the number of shares issued since no carbon has been inserted between the stock certificate and the first copy of the transfer sheet, and consequently it must be discarded. The second copy is the one used as the permanent record.

The transfer record. A record of the transfer must be made on the transfer books of the corporation. This record consists of entries on transfer sheets illustrated in Form 782, bound together in a loose-leaf book. The sheets are generally about 12 by 20 inches, and entries are made on them from the old certificates.

As indicated in Form 782, the following are inserted on the left-hand or debit side: (1) the name of the old stockholder; (2) the old certificate number; and (3) the number of shares surrendered. On the right-hand or credit side, appear the following: (1) the name of the new stockholder; (2) the address of the new stockholder; (3) the new certificate number; and (4) the number of shares issued to

the new stockholder. The entries are recorded on the typewriter, or on a bookkeeping machine that automatically adds the number of old shares surrendered and the number of new shares issued.

The number of copies made of the transfer sheet depends upon the requirements of the individual corporation. One copy is always needed for the transfer record. Another copy is generally required as a "tear" sheet for posting entries to the stock ledger. The sheets are bound together in the form of a pad; in some instances carbon sheets are contained in the pad, which can be inserted in the machine by the operator without loss of time.

The sheets are dated and are numbered consecutively, each of the duplicates bearing the same number as the original. The transfer sheet is signed by an officer of the corporation authorized to effect transfers on the corporate books. The various classes of stock are generally kept in separate records. If the state of incorporation requires that stock records be kept in the company's principal office in that state, a copy of the transfer sheet is filed there. It may be required that the transfers be posted to a stock list or a stock ledger, but, unless specifically so required, the stock ledger is usually not duplicated.

Checking of stock certificates and transfer sheets. When the new certificates of stock have been drawn up, and the transfer sheets typed, a clerk other than the one who has drawn the certificates and the transfer sheets checks back against the old certificates of stock the following items: on the new certificate of stock, the name of the transferee and the number of shares to be transferred to him; and on the transfer sheet, the name of the transferor, the number of shares transferred, the old certificate number, the name and address of the transferee, the number of shares to be issued in his name, and the new certificate number. As the old certificates and the new certificates are being checked against the transfer sheet, the clerk separates the old certificates from the new ones, inserts the new certificate numbers on the respective window receipts, totals the number of shares surrendered and the number of shares issued on each transfer sheet, and then puts his initials on the transfer sheet as evidence of the fact that the certificates have

As a further check, a grand total is taken of all the shares appearing on the debit side of all the transfer sheets and of all the shares appearing on the credit side of the sheets. Unless there has been an original issue of stock or a retirement of stock, these totals must

Form 782—Stock transfer sheet.

agree, for a new share is issued for each share surrendered. A grand total is also taken of the number of shares appearing on the old certificates and on the new certificates. These must likewise be equal, and must agree with the grand total obtained from the transfer sheets. The totals may further be checked by adding the number of shares as called for by the window tickets.

Signing certificates of stock. Certificates of stock are generally not presented to the corporate officers for signature each time a certificate is required to be issued. In most corporations, the certificates of stock kept on hand bear the facsimile signatures of the proper corporate officers. In some corporations, the certificates bear the facsimile signature of the president, but the secretary or the treasurer affixes his countersignature as the certificates are issued.⁶ In any event, the stock certificates must be countersigned by the transfer agent of the corporation as each certificate is issued. In most transfer departments several people in the department are authorized, as transfer agents, to sign the stock certificates. This not only relieves the head of the transfer department from the mechanical task of signing many stock certificates, but prevents any delay in the forwarding of the new stock certificates to the registrar for countersignature.

Countersignature by registrar. After the certificates of stock have been signed by the transfer agent, they are arranged in numerical order and delivered by messenger to the registrar for countersignature, together with the corresponding old certificates of stock to be cancelled by the registrar. As a check on such delivery, a record of the numbers of the new certificates of stock sent to the registrar, as shown in Form 783, is kept by some transfer departments. A duplicate copy of the form is kept on file in the transfer department. The original is sent over to the registrar with the certificates of stock, to be signed and brought back to the transfer department by the messenger.

In most corporations, on transfers presented at the transfer department window before noon, deliveries are made to the registrar the following morning, and the registrar counter-signs the new stock

⁶ Where one of the officers of the corporation signs each certificate as it is issued, he also initials the transfer sheet submitted to him with the new certificates.

_____ Corporation
 STREET NEW YORK, N. Y.

Date _____

..... Bank
 Wall Street
 New York, N. Y

Gentlemen:

We are sending you herewith for registration certificates of
 _____ stock of the Corporation
 as follows:

100-SHARE CERTIFICATE	CERTIFICATES FOR LESS THAN 100 SHARES	SPOILED CERTIFICATES

Total shares _____

..... Corporation

 Transfer Agent

Received from the
 Corporation for registration the above enumerated certificates of _____
 stock.

..... Bank

Date _____

By _____

certificates and returns them the same morning, together with the old cancelled certificates of stock. Certificates of stock which remain in the transfer department overnight are placed in the vaults for safekeeping.

Delivery of new certificates of stock. Upon receipt of the new certificates of stock from the registrar, duly countersigned, the portion of the window ticket retained in the transfer department (see Form 760 on page 1023) is reattached to the proper new stock certificate, and the tickets are arranged in numerical order. When a person presents to the window clerk the portion of the window ticket given to him (as indicated on page 1023) at the time the old certificate was presented for transfer, the window clerk can readily locate the proper certificate of stock by matching up the numbers appearing on each part of the window ticket. When the receipt portion of the window ticket comes to the clerk through the stock clearing corporation, he checks it against the window portion previously retained, and places the corresponding new certificate in the clearing corporation envelope for delivery to the broker.

The number of shares to be delivered and the name of the broker or other person who presented the certificate for transfer must be filled in on the window ticket for identification. The window clerk checks this information to make sure that delivery of the proper certificate is being made to the proper person. The two parts of the window ticket are pinned together and filed away in numerical order in the transfer department. In some companies, the tickets are kept in the files for as long as seven years, and then destroyed; in others, they are preserved for a much shorter period.

In New York City, firms listed on the stock exchanges are required to maintain "stock windows" in the financial district for delivery of new stock certificates. A company having a stock transfer department outside of the financial district may arrange with its registrar or with a corporate transfer agent in the financial district to deliver stock certificates for it. In such a case, the window ticket issued indicates at which office the new certificates will be delivered, upon presentation of the completed receipt. The tickets are often differentiated by color. Forms 784 and 785 illustrate window receipts

to be presented at the transfer department window, and at the registrar's window, respectively, through the stock clearing house service described above.

Errors on new certificates of stock. No erasures are permitted when new certificates of stock are executed. If an error has been made and the certificate cannot be used, the word "Void" is marked across its face. If the issuance of the new certificate of stock has

RECEIVED FROM

THE COMPANY

CERTIFICATES OF STOCK REPRESENTING

SHARES ISSUED IN 1911

OF CERTIFICATES OF STOCK DEPOSITED FOR

TRANSFER

SIGNED

DELIVERY OF THE SECURITY COVERED BY THIS RECEIPT TO BE MADE TO THE BEARER UPON COMPLETION AND SURRENDER HEREOF AT THE STOCK TRANSFER OFFICE OF THE COMPANY, EAST STREET, NEW YORK.

Form 784—Window ticket receipt—company transfer dept.

been noted on the transfer sheet before the error is discovered, a notation of the cancellation must also be made on the transfer sheet. Cancelled certificates are forwarded with the valid certificates to the registrar, so that a proper entry may be made in its records. After its return to the transfer department by the registrar, the void certificate is not destroyed but is placed with the cancelled certificates of that day's transfers.

Transfers by mail. The procedure for handling certificates received by mail is identical with that described above, except that the window ticket attached to the old certificate, and the transfer

sheet, may be stamped "Mail," and that all such certificates may be processed only after the window items have been prepared. When the new certificate is ready for delivery, its number is noted on the letter received by the corporation, requesting the transfer, and also on the window ticket. The correspondence is then turned over to the typist who prepares letters to accompany the new stock certificate to be mailed out. In the meantime, the certificates of stock are being countersigned by the transfer agent and the registrar.

	RECEIVED FROM	NO. 54-174
	THE _____ NATIONAL BANK	
CERTIFICATE OF STOCK REPRESENTING		
_____ SHARES, ISSUED IN LIEU		
OF STOCK OF THE _____ COMPANY		
DEPOSITED FOR TRANSFER AT THE OFFICE OF		
THE COMPANY.		
SIGNED _____		
BY _____		
NEW YORK _____ 19____		
DELIVERY OF THE SECURITY COVERED BY THIS RECEIPT TO BE MADE TO THE BEARER UPON COMPLETION AND SURRENDER HEREOF AT THE _____ NATIONAL BANK, STREET FLOOR, _____ STREET, NEW YORK CITY		

Form 785—Window ticket receipt—registrar's downtown window.

Registered and certified mail record. A corporation that receives many requests for transfers of stock by mail has evolved the following system of recording mail transfers. The window clerk stamps a number, with a numbering machine, on the envelope containing the certificate of stock and accompanying documents mailed in for transfer. He then places this same number on the stock certificate and on each letter and other document contained in the envelope. The number so given is the identifying mail number of that particular transfer. If the certificate of stock has been sent in by regis-

tered or certified mail, the number appearing on the envelope and given by the postoffice department is then entered on a registered and certified mail sheet as shown in Form 786, together with the name and address of the sender, the person to whom the envelope was addressed, and the window clerk who received the certificate of stock for transfer. If a certificate of stock has been sent in by ordinary mail, the letters "O.M." are inserted in the first column instead of the postal number. No entry is made of the date when the new certificate of stock is mailed out, but deliveries are followed up by means of the letters of acknowledgment described below.

Another corporation keeps a record known as a mail blotter. Every stock certificate sent in by mail for transfer is given a number, which is recorded in the mail blotter. This blotter is a bound record and indicates not only the number of the mail item, but also the date when the certificate of stock was received in the mails for transfer, the name and address of the person from whom the certificate was received, the number of shares called for by the certificate presented for transfer, and the date when the new certificate was finally forwarded. The blotter is checked about once each week to see that mail items have been taken care of promptly.

Mailing out new certificates of stock. Except for foreign mailings, which are often registered, most corporations use only ordinary mail in sending out new certificates. Selection of the class of mail-

REGISTERED AND CERTIFIED MAIL RECEIVED _____			BY _____		PAGE _____
POSTAL NUMBER	NAME	ADDRESS	ADDRESSED TO	NUMBER	RECEIVED BY

Form 786—Registered and certified mail sheet.

ing may be based on the market value of the certificates being mailed, with ordinary mail being used for certificates representing market value up to a certain amount, while registered or certified mail is used for higher amounts. Certified mail provides proof of delivery but it is not insured, as is registered mail. According to United States postal regulations, it is designed for mailing items having "no intrinsic value" such as certificates of stock.

Each certificate of stock is forwarded with a letter as shown in Form 787, duly numbered, and with a card of acknowledgment as illustrated in Form 788, correspondingly numbered, to be signed by the addressee and returned to the corporation's files. Each item is actually followed up very closely, and if the card of acknowledgment (Form 788) is not received by the corporation within a reasonable length of time, follow-up letters are sent out, and an investigation is made to see if the certificate has been lost in the mails. As a matter of general experience, mail losses are very infrequent. Some corporations carry insurance to cover the loss of certificates sent by ordinary mail.

Instead of sending the letter and card as shown in Forms 787 and 788, some corporations, when forwarding the new certificate of stock issued upon transfer, mail a letter in duplicate, similar to the one illustrated in Form 789. The addressee is requested to sign the duplicate copy of the letter and to return it to the corporation. The duplicate returned to the corporation is filed under the name of the stockholder.

Posting slips. As indicated on page 1046, one of the copies of the transfer sheet, commonly called the "tear sheet," is used in the posting of entries to the various stockholders' accounts in the stock ledger. On the left-hand side of the sheet, where the names of the old stockholders appear, are the debit entries. On the right-hand side of the sheet, where the names of the new stockholders are indicated, are the credit entries (Form 790). These debit and credit items are separated by perforations. After the transfer sheet has been typed, the perforated copy is divided into its various segments. Debit and credit sections are separated, and each section is arranged in alphabetical order, ready for entry in the stock ledger. The date

TRANSFER DEPARTMENT
OF
THE CORPORATION
..... Street
New York

No. _____

The transfer requested in your letter of recent date has been completed and we enclose certificates for stock and/or option warrants of The..... Corporation as described below.

[illegible]

Please acknowledge receipt thereof by signing and mailing promptly the enclosed post card.

Yours very truly,

•••••

Transfer Agent.

Receipt is hereby acknowledged of the enclosures
described in your Transmittal Letter No._____

(Signature of Addressee)

Dated_____

Form 788—Acknowledgment of mailed certificate of stock.

Form 789—Letter accompanying new certificate, in duplicate.

We enclose herewith stock certificates of Corporation as listed below, for shares issued as requested on , 19...., in lieu of certificates surrendered for transfer.

Certificate No.	Issued in Name of	Class	No. of Shares
.....			
.....			
.....			

Please sign and return the attached copy of this letter.

Very truly yours,

.....
Treasurer and Ass't. Sec'y.

Received the above-listed certificates and found them to be correct.

.....
(Signature)

Date , 19....

appearing on the transfer sheet is rubber-stamped on the tear slips for posting purposes.

In some corporations, the sheet is not perforated but is simply marked off by lines and divided into its various sections by means of a cutting machine.

The posting slips are used not only to make entries in the running

accounts of the individual stockholders, but to keep up to date the records of the addressograph department.

Each day's slips are kept together in alphabetical order and filed away with the other working papers covering the day's transfers. Some corporations keep the tear slips only until the end of the dividend period; when the dividend checks have been issued and the books balanced, the slips are thrown away. In other corporations, the slips remain on file for a period of about two years, after which time they are destroyed.

Posting slip envelope. The posting slips, or posting media, as they are generally called, are necessarily very small pieces of paper, which may very easily be lost in the process of passing from the sorting clerk to the ledger clerk. One transfer department which handles transfers for several corporations, each having many classes of stock, and which has hundreds of posting slips daily, obviates this danger by using the type of posting slip envelope shown in Form 791. When the posting slips are sorted into ledger divisions, alphabetized, and clipped together according to the ledger division, they are all placed in the special envelope kept for the particular class of stock. A summary of the number of shares to be debited to each ledger division and the number of shares to be credited to each ledger division, as shown by the posting slips, is inserted on the face of the posting slip envelope. The envelopes are turned over to the ledger clerks, who enter the amounts appearing on the face of the envelope on control cards, and post from the posting media to the ledger cards. The amounts on the envelope are later used to check the debit and credit postings made on the ledger cards. The posting slips are put back into their respective envelopes after posting, and are sent on to the addressograph department for the correction of stencils. The envelopes containing the posting slips are then filed away according to the dates appearing thereon.

Ledger division file for sorting posting slips. A corporation which has many posting slips to be sorted daily, preparatory to making entries in its various stock ledgers, uses a visible file to expedite the sorting process. This visible file is divided into as many compartments as there are alphabetical divisions or controls in the

Form 790—Tear sheet.

stock ledger. After all of the posting slips have been sorted into their respective compartments, they are re-sorted into alphabetical sequence within each compartment.

The stock ledger. The stock ledger contains, in alphabetical order, the running account of each stockholder. Each account indicates the number of shares purchased and transferred by the particular

Date _____

COMPANY _____

SECURITY _____

Transfer Sheets _____

Led. No.	Letter	Debit	Credit	Led. No.	Letter	Debit	Credit	Led. No.	Letter	Debit	Credit	Led. No.	Letter	Debit	Credit
1	A			26	Du			51	Kol			76	Roc		
2	Al			27	E			52	L			77	Rou		
3	Ap			28	Em			53	Lau			78	S		
4	B			29	F			54	Lem			79	See		
5	Bar			30	Fi			55	Lin			80	Echo		
6	Bau			31	Fo			56	Los			81	Se		
7	Bem			32	Fre			57	Me			82	She		
8	Bl			33	G			58	McH			83	Sl		
9	Bla			34	Ge			59	M			84	Smith		
10	Bov			35	Gl			60	Mann			85	Sn		
11	Bre			36	Gr			61	Mat			86	Spr		
12	Brow			37	Gri			62	Mes			87	Stel		
13	Bun			38	H			63	Milm			88	Stem		
14	C			39	Han			64	Moor			89	Su		
15	Carp			40	Hart			65	Mos			90	T		
16	Chas			41	He			66	N			91	Tho		
17	Cla			42	Her			67	Nl			92	Tow		
18	Coll			43	Hin			68	O			93	U-V		
19	Cop			44	Hom			69	P			94	W		
20	Cro			45	Hu			70	Pe			95	Warr		
21	Daly			46	I-J			71	Ph			96	Wels		
22	D			47	Jo			72	Per			97	Whit		
23	Daw			48	K			73	Q-R			98	Will		
24	Des			49	Kem			74	Re			99	Wo		
25	Dol			50	Kip			75	Rl			100	X-Y-Z		

Pulled _____

O. K. with Control _____

O. L. I. _____ O. I. D. _____

Posted _____

Postings Checked _____

Dr. _____ Cr. _____

Stencils Removed _____

Stencils Cut _____

T. _____ T. _____

In some corporations, the stock ledger accounts are kept in loose-

[illegible]

Form 792—Stock ledger sheet.

Ledger entries may be made by hand, or a bookkeeping machine may be used to post entries in either kind of ledger.

Active brokers' accounts are usually separated from individual stockholders' accounts whether the ledger is kept in a loose-leaf book or under a card system. Inasmuch as an active broker's account will contain many more debit and credit entries than will appear

in an individual stockholder's account, many corporations use a special, large ledger sheet for brokers' accounts. The records of various classes of stock are generally kept separately.

As indicated at page 1046, above, if a corporation is organized under the laws of a state other than that in which the transfer office is located, the laws of the state of incorporation may require that duplicate transfer records be kept at the corporation's office in that state. Where possible, this requirement is satisfied by maintaining there a duplicate set of transfer sheets. Duplicate stock ledgers are not maintained unless it is necessary. If a company has more than one transfer agent, the ledger records are maintained by one and the co-transfer agents are kept advised of changes posted to the central ledger. This may be done by mailing copies of the transfer sheets to the co-transfer agents each day. See page 1008.

Ledger entries by means of a bookkeeping machine. As previously indicated, entries may be made in the ledger by means of a bookkeeping machine whether a loose-leaf ledger or a card system is used. Various types of bookkeeping machines are used by different organizations, but the underlying principle is the same. The machine not only records the debit or credit entry in the stockholder's account, but it also automatically computes and records the new balance of shares remaining in the stockholder's account. In addition, it can carry forward the figures recorded in each account, so that a grand total may be computed of the total number of shares debited, the total number of shares credited, the total of the old balances in the accounts in which entries have been made, and the total of the new balances in such accounts. These totals are subsequently used in checking against the predetermined totals obtained from the posting slips. Entries shown on the ledger card in Form 793 are typical of those made by a bookkeeping machine.

"Pulling" or "stuffing" ledger cards. In some transfer departments having a card system of ledgers, the ledger cards are actually pulled out of their files, preparatory to making entries from the posting slips. A blank colored card is placed in the files to indicate that a card has been removed so that an entry may be made on it. All the cards of a particular ledger division are pulled out at the same

time. If no card appears in the files for a particular credit posting slip, the posting slip is stamped with a star or some other notation to indicate that a new card must be made up for the account. New cards

	1	2	3	4	5	6	7	8	9	—	10	20	30	40	50	60	70	80	90	100	200
..... CO. 6% CONV. PREF. STOCK SERIES "A"																					
	Date	Canceled	Issued	Balance	Certificate No.	Remarks															
1				★ 200																	
2	11-5		★ 100		• •1234																
3	11-5		★ 200		• •1346																
4	11-6	★ 100		★ 400	• •1234																
5																					
6																					
7																					
8																					
9																					
10																					
11																					
12																					
13																					
14																					
15																					
16																					
17																					
18																					
19																					
20																					
21																					
22																					
23																					
24																					
25																					
26																					

are made up on the typewriter, and are put in their proper alphabetical place in the group of cards on which posting entries must be made.

In order to prevent the loss or misplacement of any ledger card in the process of pulling it out of the files, some corporations do not remove the card from the cabinet but use what is known as a "stuffing" process. In this process, the posting slip is actually clipped on to the particular ledger card to which it refers, the card remaining in its place in the ledger cabinet. If there is no card corresponding to a particular posting slip, a colored card is inserted in the place where the card will eventually be in the ledger cabinet, and the posting slip is turned over to a typist, who makes up a new ledger card. After the stuffing process is completed, each ledger card cabinet is moved over, in turn, to the bookkeeping machine which records the entries on the card. As soon as an entry has been made on a card, it is released from the machine and put back in its proper place in the particular ledger cabinet.

Differentiating ledger cards covering many classes of stock. Different classes of stock are generally kept in separate ledger cabinets. In some transfer departments, the various classes of stock are further distinguished by means of a color system, the cards for each class of stock being of a different color. One corporation differentiates between the various classes by means of a numbering system, as shown in Form 793. Each class of stock is given a number, which is punched out at the top of the form. For example, if the number of a particular class of stock is 33, all the ledger cards covering this class of stock will be together in one file, and each card will have punched out at the top the numbers "30" and "3."

Combination of various stock ledger systems in one transfer department. As previously indicated, some transfer departments maintain their stock ledgers on cards, while others use loose-leaf ledgers. One large transfer department handling the transfers of several subsidiaries and affiliated companies uses three different kinds of stock ledgers; for small subsidiaries whose stock is rather inactive, a visible card index ledger is used. These cards are fastened into flat trays, and as a tray is pulled forward, the name of each stockholder

whose ledger account is on that tray is visible. The ledger clerk does not even have to remove the card from the tray to make his entry. For an active class of stock this system would, of course, be impracticable, since the trays would have to be rearranged constantly when new accounts were opened and old accounts closed. For companies whose stock is slightly more active than the stock of companies whose accounts are in the visible card ledger, the corporation uses a loose-leaf ledger, and entries are made in it by hand. For companies whose stock is very active, the corporation uses a card system, and entries are made on the cards by means of a bookkeeping machine.

New ledger accounts. The posting slips show when a new card must be made to accommodate a new account. In some corporations, posting slips so marked are sent immediately to the addressograph department, which makes up a stencil for the stockholder (see page 1072); an impress of the stencil is made directly on a ledger card. In other corporations, the new ledger account is made up on the typewriter, but it is later checked against the stencil; the addressograph department makes an impress of the new stencil on the back of the posting slip, and the posting slip is returned to the stock ledger clerk for checking.

Closed ledger accounts. Where, in the process of posting a debit slip to the stock ledger (see page 1058), it appears that all the shares standing in the name of the stockholder are being transferred, the slip is rubber-stamped "Closed." A similar notation is made across the face of the ledger account. In some corporations, the account is immediately removed from the files and placed in a separate closed ledger file. In others, the account is not removed until the end of the dividend period. Posting slips marked "Closed" are sent to the addressograph department in order that the old stencil may be eliminated from the addressograph files. It will be noted from Form 782 (page 1047) that the debit posting slips will not bear the address of the old stockholder. To avoid closing the account of the wrong stockholder, the ledger clerk fills in the address on the posting slip for the information of the addressograph department.

Checking stock ledger entries. Regardless of the form in which the stock ledger is kept, and regardless of the manner in which

entries are made, postings to the various ledger accounts must be carefully checked. Not only must the proper number of shares be debited or credited as shown on the posting slips, but entries must be made in the proper accounts. Whether entries are recorded by hand or by machine, they are checked against the posting slips by a clerk other than the one who made the entries. One corporation which stuffs its ledger (see page 1061), that is, clips the posting slips to the ledger cards, preparatory to making entries, instead of removing the cards, employs the following checking method. On the day following

PREFERRED STOCK			
NEW ACCOUNTS	SHARES	CLOSED ACCOUNTS	SHARES

Form 794—Checking sheet (left-hand side).

the one on which entries have been made on the ledger cards, the posting slips are handed out to checking clerks, who check back each one against the ledger cards to see that an entry has been made on the proper card. This is called "blind checking," since there is no indication in the files as to which account requires an entry in accordance with the posting slips. The checking clerk also makes what is known as a "debit check"; that is, for every item which has been

PREFERRED STOCK					
	OLD BALANCE	CREDITS	DEBITS	NEW BALANCE	STOCK CHANGED

Form 795—Checking sheet (right-hand side).

BOOKKEEPING POSTING CONTROL						ADJUSTMENTS		NUMBER OF STOCKHOLDERS			CLASS OF STOCK	
MEMORANDUM NUMBER	PREVIOUS BALANCE	DEBITS POSTED	CREDITS POSTED	LEDGER ADJUSTMENTS		PRESENT BALANCE	EXPLANATION OF	PREVIOUS	CLOSED ACCOUNTS	NEW ACCOUNTS	PRESENT	CLASS OF STOCK
				DEBIT	CREDIT							
				TO FR. SHARES	TO FR. SHARES							SHEETS NUMBERED FROM TO
1												
2												
3												
4												
5												
6												
7												
8												
9												
10												
11												
12												
13												
14												
15												
16												
17												
18												
19												
20												
21												
22												
23												
24												
25												
26												
27												
28												
29												
30												
31												
32												

Form 797—Bookkeeping posting control sheet.

issued as shown on the transfer sheets for the day. The total of the Closed Accounts Shares column in Form 794, plus the total of the Debits column in Form 795, must equal the total of shares surrendered as shown on the transfer sheets for the day.

Block sheet method of checking totals of shares debited and credited. Some transfer departments use what is known as the block sheet method of checking totals of shares issued. When the posting slips have been placed in alphabetical order and separated according to ledger divisions, a block sheet, as shown in Form 796, is made out for each ledger division, indicating the total number of shares appearing on the debit posting slips, and the total number of shares appearing on the credit posting slips for that division. This first block sheet is kept by the head of the transfer department for subsequent checking. After the items covering a ledger division have been posted from the posting slips to the ledger cards, a second block sheet is made up for the ledger division from the ledger cards by the ledger clerk on an adding machine. Each debit and credit item is entered separately on this second block sheet, and the total of the number of shares debited and the total of the number of shares credited on the ledger cards of that division are computed. The ledger clerk sends back to the head of department the posting slips entered in the ledger, which are clipped to the block sheet made up by the clerk for that ledger division. The head of department compares the totals on this second detailed block sheet with the predetermined totals appearing on the first block sheet, and if they agree, he enters the total of shares debited and the total of shares credited in the ledger in the control account for that particular ledger.

Bookkeeping posting control method of checking total shares debited and credited. Under this method the total debits and credits posted are recorded by ledger division, as in the block sheet method described in the preceding paragraph. In addition, all adjustments are listed and explained, and a running record of number of stockholders and number of shares outstanding is maintained. This type of control sheet is illustrated by Form 797.

Audit sheet method of checking total shares debited and credited. Transfer departments which post entries in their ledgers by means

COMMON		CORPORATION			STOCK DIVISION		CONTROL OF THE TRANSFER OF SHARES OF COMMON STOCK		DATE		19	
BLOCK	OLD BALANCE SHARES OUTSTANDING	TOTAL SHARES TRANSFERRED		NEW BALANCE SHARES OUTSTANDING	REMARKS							
		DEBITS	CREDITS									
A												
B												
C												
D												
E												
F												
G												
H												
I-J												
K												
L												
M												
N												
O												
P-Q												
R												
S												
T												
U-V												
W												
X-Y-Z												
SUP. A-1												
SUP. A-2												
SUP. B-1												
SUP. B-2												
TOTAL												

Form 798—Daily control record.

each ledger division are completed, a total is struck off, and the total amount of shares debited and the total amount of shares credited in that ledger division are recorded on the audit sheet, together with a total of the old balances in the ledger accounts to which entries have been posted. These totals are then compared with predetermined totals of shares posted and of old balances. Some corporations obtain the predetermined total of shares posted by running off on an ordinary adding machine the items from the posting slips. A corporation which records such totals on posting slip envelopes and on control records obtains the predetermined total from the control records. The predetermined total of old balances is obtained by adding up the number of shares appearing on the ledger cards pulled or stuffed for posting. If any discrepancy appears between the audit sheet totals and the predetermined totals, it is necessary only to recheck the items in a particular ledger division. The totals are posted to the control account covering the particular ledger division.

Daily control record. The accuracy of the various entries made in the transfer record and in the stock ledger is further checked by means of a system of controls. Inasmuch as an old share of stock must be cancelled for each new share issued, a debit entry must be made for every corresponding credit entry, and the share total of debits entered for each day must equal the share total of credits entered for that day. A daily record of the total entries made in each alphabetical division of the stock ledger is listed as shown in Form 798. Not only must the total of debits on the daily control sheet equal the total of credits, but both totals must agree with the totals of debits and credits as they appear on the transfer sheets of the day.

Entries are generally posted to the daily control record either from the block sheet, from the audit sheet, or from some other working medium, after all ledger postings have been made and checked against the posting slips. In some corporations, however, entries are posted to the daily control record by the chief clerk from the posting slips before they are distributed to the various clerks for posting to the ledger.

A monthly control record, listing the daily control entries as shown

Control accounts. Each stock ledger division has its own control account. In this account is recorded each day the total number of shares debited and the total number of shares credited on that day to the accounts in the particular ledger division which the control

<u>CORPORATION</u>						<u>COMMON STOCK</u>	<u>LEDGER CONTROL</u>
Month of _____ , 19__		Month of _____ , 10__				Month of _____ , 10__	
Balance Forward DR.		CR.		Balance Forward DR.		CR.	
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							

Form 799—Monthly control record.

[illegible]

control accounts from the daily control record. A master control account, summarizing the entries contained in all the separate control accounts, is maintained. Generally the total of debits entered on a particular day will equal the total of credits entered on that day, for shares surrendered by one person are transferred to another. If these totals do not agree, some explanation must appear in the master control account, as for example, a notation to the effect that a debit without a corresponding credit represents certain stock retired and cancelled, or that a credit without a corresponding debit represents original new stock issued.

Reconciliation with addressograph plates. Whatever system of checks and controls is used to verify the ledger card records, the addressograph plates must agree with such records at all times.

Electronic data processing (automation) applied to stock transfer records. In companies whose volume of stock transfer work is sufficiently large to justify the expense, or which employ electronic data processing (EDP) equipment for other purposes and can make it available for stock transfer records, the trend is toward maintaining stock transfer records on magnetic tape. A typical procedure is as follows. Stock transfer procedures as described above in this chapter are followed up to the point of making out posting slips. The posting slips are sent to the EDP department where the information contained on them is punched onto tabulating cards. The information is transferred from the cards onto magnetic tape which already contains for each stockholder account the following information: Stockholder's name, mailing address, dividend address, number of shares, class of stock, all ledger activity (credits, debits, balances), and other information or codings. A new tape can be run at any time, consolidating all changes recorded to date. From the tape a record is run on sheets about 12 x 15 inches. Each sheet contains the record of about twelve stockholders. The record sheets contain the following information: stockholder's name and address, account number, certificate numbers, debits, credits and share balance. This record becomes the ledger record and replaces ledger cards. As many copies of this record can be run as desired. It can be run as frequently as desired. Reproduction of the entire record for many thousands of accounts takes only a few hours. One company printed dividend checks for more than 20,000 stockholders in three hours.

Filing cancelled certificates of stock. The general practice among corporations is to fasten together all stock certificates cancelled on a particular day and file them according to the date of cancellation. Each day's certificates are, in turn, placed in numerical order according to the certificate number. In this way, if it is desired to obtain a certificate from the files, one can ascertain quickly from the transfer sheet or from the stock ledger the day on which the certificate was cancelled, and the certificate can easily be found in the files. In addition, this arrangement furnishes a ready means of determining, for transfer tax inspection purposes, what transfers were made within a certain period. Some close corporations re-

paste cancelled certificates into the stock certificate book (see page 1038).

Destruction and cremation of cancelled certificates. The policy regarding preservation of cancelled certificates of stock varies among corporations. Many preserve them indefinitely. Others cremate cancelled certificates periodically. In a typical case, this is done every seven years, but only after the material has been microfilmed. Another transfer department, under standing order of the Board of Directors, cremates cancelled certificates automatically after ten years. Corporate transfer agents may destroy cancelled certificates upon specific instructions from the corporations for which they act, or they may return the certificates to the corporation after a stated period of years. The latter is the more usual practice. The rules of the Interstate Commerce Commission provide that railroads may, under certain conditions, destroy cancelled stock certificates or bonds. The Treasury Department requires that cancelled certificates bearing tax stamps must be kept for four years before destruction.⁷ Tax stamps may be microfilmed where done for records retention purposes.⁸ The trend is for both stock transfer departments and stock transfer agents to microfilm certificates and bonds before destruction. For forms of resolutions authorizing destruction of cancelled certificates see Forms 129 and 130, page 388. It is customary for the certificates to be cremated in the presence of several persons, who execute an affidavit, known as a "Cremation Affidavit Certificate." They swear that they have, in the presence of one another, destroyed the certificates described in detail in the affidavit. See Form 801.

Change of address. When a stockholder notifies the corporation of a change in his address, a numbered address voucher as shown in Form 802 is filled out and sent by the transfer department to the addressograph department. The stockholder's stencil is immediately corrected, and an impress of the old and the new stencil is made upon the address voucher, to make sure that the new stencil has been changed in accordance with the instructions, and that the proper old addressograph plate has been removed. The voucher is then turned

⁷ See Treasury Dept. Reg. 71, §113.150.

⁸ See Treasury Dept. Rev. Rul. 56-569, 1956-2 Cum. Bull. 1002.

Form 801—Cremation affidavit certificate.

State of }
County of } ss.

..... and, being duly and severally sworn,
do each severally depose, certify, and say:

We, ... and, have this day of,
19...., at No. Street, in the City and State of,
in the presence of one another, destroyed, by burning to ashes, the property
described in detail below.

.....
.....
.....

Representing

Representing Company
Corporate Trust Dept.

Sworn to before me this }
day of, 19.... }

Representing Company
Coupon Verification Dept.

.....
Notary Public

Accepted
..... Company

.....
Asst. Secretary

over to the ledger clerk, who makes a notation of the change in address in the stockholder's ledger account, either on the typewriter or by hand.

To keep the addressograph files up to date, most corporations forward to the stockholder a notice such as that illustrated in Form 803, when proxies for the annual stockholders' meeting or when dividend checks are mailed. If there has been a change in the stockholder's address and he returns the form, properly filled in, it is sent to the addressograph department, which cuts a new stencil for the stockholder. An impress of the stencil may be made on a form similar to the form shown in Form 804 and forwarded to the stockholder. A notation of the change is, of course, made in the stockholder's ledger account, and the old addressograph plate is removed. Some

companies print an address form on the back of the dividend check itself to be completed by the stockholder at the time that he endorses the check. This procedure necessitates the physical examination of each returned cancelled check to determine if there has been a

STOCK TRANSFER DIVISION		ADD. Vo. Nº 3271
TO ADDRESSOGRAPH DEPT. PLEASE CHANGE ADDRESS OF THE FOLLOWING		
FROM	TO	
IMPRINT OF PLATE REMOVED	IMPRINT OF NEW PLATE	
	ADD. Vo.	

Form 802—Notice to addressograph department of change of address.

NOTICE OF CHANGE OF ADDRESS	
_____ CORPORATION _____ 19__ STOCK TRANSFER OFFICE _____	
PLEASE PRINT OR TYPEWRITE Change address of Name..... (Please indicate Mr., Mrs. or Miss) From Street and Number City State To Street and Number City State Signature Signature must correspond with name of stockholder on stock certificate	

Form 803—Blank notice of change of address sent to stockholders.

change of address. Many companies having a large number of stockholders do not use the procedure for this reason.

CORPORATION STOCK TRANSFER OFFICE , NEW YORK, N. Y.
In accordance with instructions received we have recorded your change of address on the books of this Corporation to read as shown below. Yours very truly, Asst. Sec'y and Asst. Treas.

Form 804—Notice that change of address has been received.

Consolidation of accounts. A stockholder may acquire stock at various times, and, because of some slight difference, upon registration of the stock, in the spelling of his name or in his address, a new account may be opened for him each time he becomes the owner of some of the stock. Not only will several ledger accounts for the same person be opened, but several stencils may be made up and kept in the stencil files. When notices are sent out to stockholders, a stockholder for whom several accounts have been opened and several stencils cut will receive as many notices as there are stencils for him in the files. The corporation will not consolidate the accounts without first making sure that the person holding the various blocks of stock is the same, or without proper authorization from the stockholder. Some corporations keep on hand a form letter as shown in Form 805, to be sent to stockholders having several accounts, requesting authorization to consolidate.

It will be noted that the corporation does not list any of the details of the stockholding. The stockholder is required to fill this in-

formation in himself, to assure the corporation that the authorization is made by the proper person.

Form 805—Letter to stockholder requesting authorization for consolidation of accounts.

For the purpose of verifying your account as a holder of our stock, we would appreciate your advising us, in the form below, of the numbers of your stock certificates, together with your name, *exactly* as they are shown thereon.

This request is made so that we may know if it is in order for us to consolidate your account with another account of a similar name.

Your kind coopération in this matter will be appreciated.

Very truly yours,
.....
Transfer Agent

Certificate No.	Name, Exactly as Shown on Certificate	Number of Shares
.....		
.....		
.....		

If a prefix or title precedes the name on any of the above certificates and is omitted on others, please answer the following questions:

- 1. Is the registered owner of all the above certificates one and the same person?
- 2. Do you desire the accounts consolidated?
- 3. In what name should the account be kept?

Signature
Correct Address Street, ..., ...

Under the policy of some corporations a mere authorization to consolidate is not sufficient, and the stock certificates must be formally transferred into the same name. The corporation sends out a letter like that shown in Form 806, requesting that the stockholder indicate the name into which the transfer is to be made, and that he endorse and submit the certificates for transfer.

Form 806—Letter to stockholder requesting transfer of certificates to same name.

Our records of your holdings in our Company indicate that your certificates are issued with a slight difference in the names as follows:, ...

It is our desire to consolidate these accounts, but as it is required that the stock records agree identically with the outstanding certificates, we suggest that you transfer the necessary certificates so that the name on each certificate will be the same.

If you wish to do this, a special indorsement is required. For example: "James M. Smyth, incorrectly inscribed on the within certificates as James M. Smith." (Please bear in mind in making the transfer that the full given name is required, that is, "James M. Smyth" rather than "J. M. Smyth.") This indorsement should then be guaranteed by a national bank or trust company, located in or having a correspondent in New York, or by a New York Stock Exchange firm. Certificates forwarded to us should be sent by insured, registered mail.

You need not affix transfer stamps to these certificates, as there is no change of ownership involved.

Very truly yours,

.....
Transfer Agent

Transfer records of subsidiaries and affiliated companies. Many large corporations having various subsidiaries and affiliated companies effect transfers of stock of these subsidiaries and affiliates in their main transfer department. The window ticket will show the name of the company whose stock is presented for transfer. Separate transfer sheets will be made up for the particular company. In some cases, the main transfer department will also keep the stock ledger in its office, make entries into the stock ledger of the subsidiary from the transfer sheets, and send a copy of the transfer sheet to the home office of the subsidiary. Other corporations send to the subsidiary not only a copy of the transfer sheet, but the tear sheet for posting entries to the stock ledger; and the stock ledger is actually maintained in the office of the subsidiary rather than in that of the parent corporation.

Corporations having more than one transfer office. A corporation may maintain an office for the transfer of its stock in several cities. This is particularly true where the stock is listed on several exchanges and the rules of the various exchanges require that a transfer office be maintained in the city in which the exchange is located. New certificates of stock are generally made up in and delivered by the respective offices to which presentation for transfer was made. Transfer sheets are also generally drawn up in that office, copies thereof, including the tear sheet, being forwarded each day to the principal office of the corporation. The stockholders' ledger is kept in the principal office, and entries are posted to the ledger in that

office from the tear sheets forwarded to it. It is customary also for the subsidiary office to send to the principal office a copy of its record of certificates issued.

Files of transfer department. Files of the transfer department may be divided into the following sections:

1. Correspondence.
2. Legal documents.
3. Stop transfer orders.
4. Change of address.
5. Cancelled and void certificates.
6. Miscellaneous records.

Correspondence. In the regular correspondence file, alphabetical files arranged according to the name of the shareholder are maintained. In addition to the above, there may also be maintained a chronological file of all correspondence. In no case are stock certificates, legal documents, or ledger cards placed in the correspondence section of the file. Incoming correspondence which has been referred to the files without acknowledgment may be filed only after it has been initialed by the head of the transfer department or his assistant.

Legal documents. Legal documents used in connection with the transfer of stock may be kept in the legal document section of the files, and if there is any reason for removing any of these documents from the file, an out-card must be placed in the file, bearing the name of the person receiving the document.

Stop transfer orders. When correspondence relating to stop transfer orders is received, a lost securities envelope is prepared, in which the correspondence is inserted. The envelope is then placed in the stop transfer order file in alphabetical sequence. The file copy of the stop transfer order itself, however, is retained in the pending file until acknowledgments have been received from the various addressees, and a file copy of the stop transfer order, with the various acknowledgments attached, is then placed in the proper lost securities envelope.

Change of address. Correspondence and forms covering changes of address may be filed alphabetically in a separate file.

Cancelled and void certificates. Cancelled stock certificates may be filed numerically or according to the date of cancellation in the cancelled certificate section of the file. Voided certificates may be filed with other cancelled certificates, or they may be placed in numerical order in a voided certificate section of the file.

Miscellaneous records. Closed ledger accounts are filed alphabetically in the closed account section of the bookkeeping department files. Transfer sheets are kept in the post binder and permanently bound periodically.

Rules for determining alphabetical sequence in filing. In departments having extensive files, it is important that rules be laid down for determining alphabetical sequence in filing, for much time may be lost in locating papers if various file clerks place them in the files in different sequences. File clerks should be required to familiarize themselves with such rules and to adhere to them.⁹

CORPORATE PROCEDURE WHERE TRANSFER AGENT IS EMPLOYED

Duties of corporation. Where a corporation employs a transfer agent, it is concerned only with the following details in connection with the stock issue:

1. Appointment of the transfer agent.
2. Authorization of the issuance of stock.
3. Notices to the transfer agent authorizing the issuance of stock to designated individuals.

All of the procedures connected with the recording of the original issuance of stock or with its transfer are established and conducted by the transfer agent. The agent maintains the stock ledger records. If the laws of the state of incorporation require it, duplicates of these records are maintained at the principal or registered office of the corporation in that state.

Change in transfer agent. A corporation may change its transfer agent by following the procedure given below:

⁹ An example of an excellent set of workable rules for alphabetizing will be found in Doris and Miller, *The Complete Secretary's Handbook*, Prentice-Hall, Inc., pp. 35-40.

1. A meeting of the directors is held and a resolution passed terminating the contract with the old transfer agent.
2. At the same directors' meeting, a resolution is passed appointing a new transfer agent. The form of resolution furnished by the new transfer agent is used for the resolution of appointment.
3. If demanded by the old transfer agent, a release is executed by the corporation through its proper officers, relieving the old transfer agent of all liability, past, present, and future, upon transfers made by it.
4. The new transfer agent will obtain from the old transfer agent all the records of the corporation involving the transfer of its stock. Stencils are considered the property of the transfer agent and need not be turned over to the new transfer agent. The old transfer agent may, however, arrange to sell the stencils to the new transfer agent.
5. A stock list, showing the stockholders of record on the day of the change in transfer agents, is prepared at the corporation's expense.

The change of agents is generally effected on a Friday night in order to give the old transfer agent an opportunity to bring its books up to date and to make preparations for the change.

The certificates of stock outstanding remain valid even though signed by the transfer agent in charge at the time the certificates were issued, and therefore nothing need be done about calling in the certificates that are outstanding. The new certificates will bear the signature of the new transfer agent.

TRANSFER PROCEDURE IN SMALL CORPORATIONS

Comparison with procedure in large corporations. Transfers of stock in a small corporation are effected by the secretary or treasurer of the corporation. The officer in charge is familiar not only with the general practice followed in transferring stock, but with the legal

principles affecting transfers, and he is competent to pass upon the documents presented. If an unusual case is encountered and the officer is in doubt as to the legality of the transfer, counsel for the corporation is consulted.

The transfer procedure for small corporations follows the procedure outlined for larger corporations in its essential details, and generally differs only in the following respects:

1. Instead of having on hand a supply of stock certificates, signed in blank by the corporate officers, the corporation generally keeps a bound stock certificate book for each class of stock. As each certificate is issued, the name and address of the person to whom the certificate is issued are entered on the stub, and the certificate is torn out of the stock certificate book. A receipt for the certificate is sometimes signed on the stub itself. Where this cannot be done, a signed receipt is pasted on the stub of the certificate issued. In some corporations, certificates in the bound stock certificate book are signed prior to issuance by an officer of the corporation, and the secretary or treasurer having charge of transfers countersigns as each certificate is issued.

2. The new certificates are often filled out by hand.

3. The transfer record is not typed on transfer sheets, but is written by hand into a bound transfer book, such as is shown in Form 807.

4. The stock ledger may be kept either in a bound book or in loose-leaf form, alphabetically arranged. The pages are sometimes numbered (see Form 808). Entries to the stock ledger are posted from the transfer record, and where the ledger pages are numbered, an entry is made in the transfer record of the ledger page to which the entry has been transferred.

5. Old cancelled stock certificates are pasted back into the bound stock certificate book opposite their respective stubs (see page 1038).

Although small corporations handle their own transfers, they sometimes employ some bank or trust company as registrar.

PROCEDURE FOR RECORDING ORIGINAL ISSUANCE OF STOCK

Definition of original issuance. A corporation may issue stock: (1) as an original issue at the time of organization; (2) as an additional issue of stock already authorized; or (3) upon an increase in the amount of its authorized stock. Strictly speaking, only the first case is an original issuance. However, the expression "original issuance" is generally applied to any issue of stock which is not the result of a transfer or an exchange, and which does not involve the surrender of outstanding stock certificates. In the following paragraphs, the term original issuance is used in its general sense.

Method of recording an original issuance of stock. Although an original issuance of stock does not constitute a transfer, the issuance is actually recorded in the transfer books of the corporation. The transfer department receives from the proper corporate officers authorization to issue certain stock to designated persons. This authorization is usually in the form of a resolution of the board of directors or of the stockholders, which is kept permanently on file in the transfer department. Certificates of stock are drawn up and executed in the same manner as upon a transfer of stock. Transfer sheets are made up as indicated on page 1045, except that on the debit side there appear merely the words "Original issue, as per resolution of board of directors, dated, 19. . . .," or some other notation of the authority for the issuance of the stock. The credit side of the transfer sheet shows the name and address of the person to whom each certificate of stock is issued, together with the certificate number and the number of shares issued. These credit items are posted to the stock ledger in the same manner as upon a transfer of stock, new accounts being opened where necessary.

Record of original issue stamps. If the certificates of stock are printed with stubs, the stamps are pasted to the stub. If there are no stubs, as is usually the case where large amounts of stock are issued, the stamps may be pasted to the transfer sheets, or they may be kept by the corporation in a separate binder known as an original issue

stamp book. The original issue stamp book records the number of shares issued and the date of issuance, as well as the authority pursuant to which the stock was issued. The stamps are pasted into the book opposite the entry of the issue which they cover. The original issue stamp book is kept premanently in the vault of the corporation, open for inspection by government officials.

Whether stamps are pasted to the stub, on the transfer sheet, or in an original issue stamp book, they should be cancelled as required by law.

Authorization ledger. The head of the transfer department keeps a book known as an authorization ledger, in which an account for each class of stock is maintained. The purpose of these accounts is to keep the corporation informed of the total amount of outstanding stock of each particular class, and the amount which the corporation may issue in the future.¹⁰ Some corporations keep their authorization ledger accounts on ordinary stock-ledger sheets, as shown in Form 792. In the right-hand corner of the card, the total number of shares authorized and the date of authorization are written in red ink. On the debit side of the account, the dates when stock was retired, the circumstances under which it was retired, and the number of shares retired on the respective dates are entered. On the credit side are listed the dates of original stock issues, the authority for issuance, the number of shares issued, and the next amount outstanding.

Other corporations use a more elaborate form for their authorization ledger accounts, such as is shown in Forms 809 and 810. The form is made up of two parts, Part I, as shown in Form 809, and Part II, as shown in Form 810. On Part I are entered the details of the blanket authorization to issue shares, and the details of the respective orders to issue against the amount authorized. On Part II are entered the actual bookkeeping figures of the various authorizations and orders. A sheet such as is shown in Form 811 may also be used. This form is not in the nature of an account with a debit and credit side, but contains merely a column to record increases, decreases, and the balance of stock outstanding.

¹⁰ Note that it is also the duty of the registrar to see that shares issued are within the amount authorized.

COMPANY			CLASS OF STOCK			
CAPITAL						
ADDRESS			REGISTRAR			
CO-TRANSFER AGENTS						
CO-REGISTRARS						
LISTED ON			STOCK EXCHANGE			
INCORPORATED-LAWS OF						
DATE	CK. BY	NO.	AUTHORIZED BY BOARD OF DIRECTORS	NO. SHARES	TOTAL NO. SHARES	
DATE	CK. BY	NO.	ORDERS FOR DELIVERY OF SHARES AS PER ABOVE RESOLUTION	NO. SHARES	TOTAL NO. SHARES	

Form 809—Authorization ledger sheet (part 1).

COMPANY										CLASS OF STOCK	
	DATE	AUD.	NO.							TOTAL NO. SHARES OUTSTANDING	

Form 810—Authorization ledger sheet (part 2).

[illegible]

Form 811—Authorization ledger sheet (another form).

**PROCEDURE IN CONNECTION WITH STOCK
PURCHASE WARRANTS**

Introduction. The nature and underlying principles of stock purchase warrants have been discussed in Chapter 19. The remainder of this chapter is concerned with detachable or nondetachable warrants that are ordinarily issued to purchasers of new issues of securities and that may be exercised over a period of years. They are to be distinguished from rights to subscribe, which are usually issued to stockholders when capital stock is increased, and are of short duration. See also page 873.

Corporations that employ a bank to act as transfer agent generally appoint the same bank as agent for the handling of warrants. In corporations having their own transfer departments, all the details connected with the warrants may be attended to by the transfer department; the corporation may, however, appoint an agent for this work, in order to avoid the necessity of handling the cash paid upon the exercise of the warrants. In general, the procedure is the same whether the warrants are handled by a transfer agent or by a corporate transfer department. For minor differences in procedure, however, see page 1093.

Since bearer warrants are handled in a different manner from warrants issued in the name of a designated person, the two classes of warrants are considered separately.

BEARER WARRANTS

Issuance of bearer warrants. Whether bearer warrants are detachable or nondetachable, no record is made of them at the time of issuance, apart from the record of the certificates of stock or other securities to which the warrants are attached. If such warrants are attached to stock, the issuance of the stock with the warrants is recorded on transfer record sheets, like any ordinary stock issue. Both the transfer sheet and the stock ledger to which the transfer sheet entries are posted bear a notation to the effect that the stock has warrants attached.

The amount of stock held in reserve to meet requirements upon the exercise of the bearer warrants is recorded in the Authorization Ledger account (see page 1086).

Transfer of bearer warrants. Detachable bearer warrants may be transferred from one person to another by delivery without recording on the books of the corporation. If the warrants are nondetachable, they can be transferred only by a transfer of the certificates of stock to which they are attached. Such a transfer is handled like any ordinary transfer of stock, entries being made on transfer sheets covering the particular class of stock with warrants attached, and in the ledger covering the same class (see page 1045, et seq.).

Exercise of detachable bearer warrants. To exercise a detachable stock purchase warrant, the holder of the warrant must present it to the transfer department, together with payment for the stock as fixed by the terms of the warrant agreement. If the warrant holder pays the purchase price by check rather than by cash, the transfer department must be careful not to issue the stock certificates until the check has cleared. A transfer sheet is drawn up, covering the class of stock issuable upon exercise of the warrant. On the credit side of the sheet are inserted the name and address of the person to whom the new certificate of stock purchasable under the warrant is

being issued, the number of the stock certificate, and the number of shares issued. On the debit side of the transfer sheet is entered a notation to the effect that the stock is issued upon exercise of the warrants. The credit entries are posted to the respective stockholders' accounts in the stock ledger covering the class of stock issued.

An entry is made in the Authorization Ledger account (see page 1086) to indicate the number of shares actually issued against the amount reserved for the exercise of stock purchase warrants.

Exercise of nondetachable bearer warrants. When the holder of a nondetachable bearer warrant desires to exercise his warrant, he must present the certificate of stock or other security to which his warrant is attached, together with payment for the stock he is purchasing. The warrant is detached from the security by the transfer department and is then treated like any detachable warrant presented for exercise, as explained above.

In some companies, the stock certificates from which the warrant has been detached is returned to the stockholder, with a legend stamped on the certificate to indicate that the warrant has been exercised.¹¹ In other companies, the transfer department cancels the certificate of stock presented and issues a new certificate of another series, the number of which indicates that the stock is issued *ex-warrant*. Transfer sheets are made up to record the surrender of the old certificate and the issuance of the new certificate of stock *ex-warrant*. Entries are posted to the stock ledger as in the case of any ordinary transfer of stock (see page 1058).

Disposition of cancelled bearer warrants. As previously indicated, upon the transfer of nondetachable bearer warrants, the certificate of stock to which the warrant is attached must also be transferred. The warrant, which remains attached to the certificate of stock, is perforated for cancellation as is the certificate of stock. The cancelled stock certificate with the warrant attached is filed away and kept permanently, like any ordinary cancelled stock certificate.

Upon the exercise of bearer warrants, the surrendered warrants are cancelled by perforating the signatures thereon in the same man-

¹¹ If the stock is listed on an exchange, it may be necessary to obtain the permission of the exchange to place this legend on the certificate.

ner as upon transfer, and are then filed away numerically. They are kept for a period of years, after which time they may be cremated like other bearer securities.

REGISTERED WARRANTS

Issuance of registered warrants. Warrants issued to purchasers of new issues are generally in bearer form. In some instances, however, they have been issued in registered form, that is, in the names of designated persons. One corporation which issued such registered warrants had the warrants made up as instruments separate and apart from the securities which they accompany.¹² The warrants were treated like any new class of stock, and their issuance was recorded accordingly. Upon issuance, warrant transfer sheets were made up as shown in Form 812.¹³ On the credit side, the names and addresses of the persons to whom the warrants were issued, the warrant numbers, and the number of warrants issued to each person were entered. On the debit side, a notation was made of the authority under which the warrants were issued. The credit items were posted to the accounts of the respective warrant holders in a separate warrant ledger. The amount of stock reserved to meet requirements upon the exercise of the registered warrants was recorded in the Authorization Ledger account.

Transfer of registered warrants. Warrants issued to designated persons are transferrable in the same manner as certificates of stock. The assignment on the back of the warrant must be executed, the signature must be guaranteed, and the warrant must be presented for recording the transfer on the corporate books. Some transfer departments have separate window tickets which they use upon presentation of warrants for transfer. Others use the ordinary window ticket and indicate that it covers stock purchase warrants. As in the case of transfers of stock, transfer sheets are made up either on a separate sheet as shown in Form 812, or on a transfer sheet as shown in Form

¹² In this particular instance, the warrants did not have an expiration date, as is usually the case, but could be exercised indefinitely.

¹³ The regular type of transfer sheet may be used instead of this special form; in this event, a notation should be made at the head of the sheet to indicate that it covers stock purchase warrants.

782, on which a notation is made to the effect that the sheet covers stock purchase warrants. On the debit side, the number of the window ticket issued, the name of the person whose certificate was surrendered, the warrant number, and the number of warrants surrendered are entered. On the credit side of the transfer sheet, the name and address of the person to whom the new warrants are issued, the new warrant number, and the number of warrants issued are noted. Debit and credit entries on the transfer sheet are posted to the respective ledger accounts of the warrant holders.

○ OPTION WARRANTS TO PURCHASE COMMON STOCK, CLASS "A" ○ OF CORPORATION By virtue of the full and power of attorney to transfer endorsed upon each warrant (or attached thereto), the option warrants to purchase Common Stock, Class "A," represented by warrants described on this page, are hereby transferred by the undersigned attorney, as hereon set forth. Date:						
RECEIPT NO.	WARRANTS SURRENDERED	Warrant Number	No. of Warrants	WARRANTS ISSUED	Warrant Number	No. of Warrants
TOTAL				NO 746	TOTAL	

Form 812—Warrant transfer sheet.

Exercise of registered warrants. Warrants must be presented with the amount fixed as the price of the stock purchasable under the warrant. The assignment on the back of the warrant must be executed as upon transfer of the warrant, and the signature must be guaranteed. If payment is made by check, the stock is not issued until the check has cleared. The surrender of the warrant is recorded on a transfer sheet made up in the same form as that used upon issuance of the warrant.¹⁴ On the debit side are entered the

¹⁴ It will be recalled that some corporations record the issuance of the warrants separately from the stock which the warrants accompanied, whereas others merely record the issuance of the stock and indicate that the stock had purchase warrants attached.

name of the person who surrendered the warrant, the warrant number, and the number of warrants surrendered. On the credit side of the transfer sheet appears a notation to the effect that the warrant was surrendered for exercise pursuant to the stock purchase warrant agreement. The debit entries are then posted to the respective warrant holders' accounts.¹⁵ The issuance of the stock purchased is recorded like any original issue of stock; that is, a transfer sheet is made up to cover the stock issued. On the credit side are entered the name and address of the person to whom the stock is issued, the stock certificate number, and the number of shares. On the debit side appears a notation stating that the stock was issued pursuant to the exercise of the stock purchase warrants. The credit entries are then posted to the respective stockholders' accounts in the stock ledger covering the new stock issued.

An entry is made in the Authorization Ledger account to indicate the number of shares actually issued against the amount set up as a reserve for the exercise of the warrants.

Disposition of cancelled registered warrants. Cancellation of registered warrants, surrendered either upon transfer or upon exercise of the warrant, is effected generally in the same manner as cancellation of certificates of stock. If the warrant has been countersigned by a transfer agent and by a registrar, a perforation must be made through their signatures. If the warrant has been signed only by officers of the corporation, a perforation must be made through their signatures. The cancelled warrants are filed away numerically according to warrant number, and are preserved like certificates of stock.

HANDLING OF WARRANTS BY AGENT

Procedure. A bank which acts as agent for the handling of stock purchase warrants generally follows the procedure outlined for corporate transfer departments in the preceding paragraphs. However, the work involved upon the exercise of the warrants is divided between the bank's transfer department and some department that is

¹⁵ These accounts may appear in a separate warrant ledger, or in the ledger covering the stock which the warrants accompanied,

equipped to handle cash items, as for example, the trust department. Warrants are presented for exercise to the trust department, together with the amount required to pay for the stock. When the checks received have cleared, the trust department sends a requisition to the transfer department to issue stock certificates to specified persons, in designated amounts. Certificates of stock drawn up pursuant to such requisition are sent by the transfer department to the trust department, which makes a record of the warrant numbers presented for exercise and the certificates of stock issued therefor, and effects delivery of the certificates of stock purchased. The surrender of the warrants and the issuance of the stock are recorded by the stock transfer department on the transfer records and in the stock ledger.

CHAPTER 25

PROCEDURE FOR LOST, STOLEN, OR DESTROYED CERTIFICATES OF STOCK

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Procedure for Lost, Stolen, or Destroyed Certificates of Stock

Introduction. With the increasing diffusion of stock ownership, there has been a corresponding increase in the number of lost certificates. As a preventive measure, some corporations send special notices to stockholders, pertaining to the safeguarding of stock certificates (see Form 813), or furnish an envelope in which to keep stock certificates. On this envelope is printed a warning against carelessness (see Form 814). In spite of such warnings, however, nearly every corporation is called upon at some time or other to issue duplicate certificates of stock in place of certificates which have been lost, destroyed, or stolen.

The legal principles relating to the issuance of such duplicate certificates have previously been discussed (see page 974). It was pointed out there that the statutes governing the corporation and the corporate by-laws usually indicate the conditions under which such replacements will be made. The following paragraphs outline the procedure generally followed by corporations in replacing lost certificates of stock. Where a corporation has its own transfer department, lost certificates are handled by that department. Where a corporation employs a transfer agent, the latter attends to the details of replacing certificates. The steps required to be taken in either case are the same.

CARE OF STOCK CERTIFICATES

In view of the frequent losses of stock certificates, from one cause or another, resulting in expense and trouble to the stockholder or his family, it is hoped that the following suggestions will be of benefit to some of our stockholders:

1. Keep your certificates in a safe place. A bureau drawer, trunk, or coat pocket is not a safe place.
2. A surety bond is required before new certificates will be issued to replace those which have been lost. Bonds are expensive.

3. Do not sign your name on your stock certificates until you are ready to dispose of them. If you do, they may be transferred out of your name without your knowledge.

4. When considering the sale of certificates, consult a reputable banker, broker, or other competent person whose integrity cannot be questioned. Do not surrender them for any reason without careful investigation.

5. Keep a record of your certificates, their numbers, the number of shares, etc. It may be useful.

6. In forwarding certificates anywhere, for any purpose, it is well to do so by registered mail.

7. If your certificates are lost or stolen, please notify the corporation immediately; also inform the company if and when they are recovered.

Form 813—Notice to stockholders to safeguard stock certificates.

**KEEP YOUR COMPANY
PREFERRED STOCK IN THIS ENVELOPE**

**Keep it where it will not be lost, for it is expensive
and troublesome to replace a lost certificate.**

**In case you do lose it, write to us at once, and we
will issue orders to stop transfer on it.**

Name

Address Street

City , ...

Form 814—Warning against loss, printed on stock certificate envelope.

Procedure in replacing lost certificate. The following are the steps taken prior to the issuance of a new certificate of stock in place of one lost, destroyed, or stolen:

1. The stockholder notifies the corporation of the loss of the certificate and requests the corporation to stop transfer. The letter advising the corporation of the loss of a stock certificate is forwarded to the stock bookkeeper who ascertains whether the certificate in question is outstanding. A form like the one shown in Form 815 may be used to show the bookkeeper's verification of the name in which the

1098 PROCEDURE FOR LOST CERTIFICATES OF STOCK

certificate is registered, the date the stock was issued, the certificate numbers, class, par value, and number of shares. This form would be attached to the stockholder's letter and passed along to the persons whose duty it is to note the loss and who affix their initials in the blanks indicated.

Loss Reported , 19....
Stock Certificate No.
For (....) Shares
(Common) (Preferred) Class
Par Value Per Share
Date Issued , 19....
Issuance Verified by

RECORDED ON:

Transfer Clerk's Chart
by
Ledger Account
by

REGISTRAR NOTIFIED:

by
on , 19....

Form 815—Lost certificate notations.

2. The stock transfer department immediately records the stop order in its transfer records and sends out notices of the stop order to the registrar, to the co-transfer agent, if there is one, and to any interested persons. It also acknowledges receipt of the stop order from the stockholder and urges him to make a careful search for the certificate in order to avoid the trouble and expense of replacement.

3. The stockholder may be required to execute an affidavit as explained on page 1107, indemnifying the corporation against any loss which it may suffer in carrying out the stop transfer order, and agreeing to furnish a bond in the event that the certificate is presented for transfer.

4. A period of time, generally from several weeks to six months, is allowed to elapse, during which time a stop transfer order is in effect, but no new certificate of stock is issued.¹

5. The stock transfer department then sends to the stockholder a letter as shown in Form 816, outlining its requirements for the replacement of the lost certificate.

6. The stockholder executes the affidavit of facts of the loss and proof of his ownership of the lost certificate of stock (see Form 817).

7. The stockholder furnishes a bond as shown in Form 818, indemnifying the corporation, its transfer agent, and its registrar against any loss which they may incur by reason of the issuance of a duplicate certificate of stock. The bond is executed in triplicate: one copy is retained by the transfer department,² another by the registrar, and the third by the bonding company.

8. If the directors have not previously adopted a blanket resolution authorizing the transfer department to issue duplicate certificates in place of certificates lost, destroyed, or stolen, where the required conditions have been met, a separate resolution (Form 123) is passed authorizing the issuance of the duplicate certificate of stock in the particular case. Some companies adopt a blanket resolution authorizing the replacement certificates for not more than 100 shares, and employ a separate resolution for each case in which the lost certificate is for more than 100 shares. For a discussion of blanket bonds see page 1106.

Form 816—Letter to stockholder outlining requirements for replacement of lost certificate.

STOCK TRANSFER DIVISION

Subject: Requirements for Replacing Lost Stock Certificates

With reference to our recent correspondence regarding the Corporation common stock certificate which you reported as lost, mislaid, or stolen, we are enclosing herewith:

1. Affidavit of facts. This must be executed in triplicate before a notary, who must attach county clerk's certificate showing his authority to act as a notary.

¹ For the procedure upon the presentation of stock certificates for transfer during the waiting period, see page 1106.

² Where a transfer agent is employed, the corporation generally keeps one copy of the bond in its own files, and another copy is kept by the transfer agent.

2. Indemnity bond. You will find complete instructions as to the execution of this bond on the last page thereof. These instructions must be rigidly followed, and any failure to do so will only result in delay in the issuance of the replacing certificate.

When these forms have been completed, kindly forward them to the writer, who will submit same to our directors for approval and authority to issue new certificate.

If the affidavit and bond are not filed with us within thirty days of the date of this letter, we will consider that your notice of loss of the certificate has been withdrawn. If the stock certificate is found, please notify us at once.

Very truly yours,
.....
Transfer Agent

Form 817—Affidavit of facts for issuance of new certificate.

AFFIDAVIT OF FACTS

**REQUIRED IN CONNECTION WITH THE ISSUANCE OF NEW STOCK CERTIFICATE TO
REPLACE LOST, STOLEN, OR DESTROYED CERTIFICATES**

State of }
County of } ss:

..... (hereinafter called "affiant"), being duly sworn, deposes and says: That this affidavit is made to induce Corporation, its Transfer Agent, its Assistant Transfer Agent, and the Bank, its Registrar, to stop the transfer of the certificates hereinafter described, representing shares of the stock of said Corporation, which have been lost, stolen, or destroyed, and to issue and deliver to the affiant, or to the affiant's order, new certificates in lieu thereof, representing a like number of shares; and that all the information contained in this affidavit, including the answers to the following questions, are true, to the best of the affiant's knowledge:

- 1. Address of affiant
- 2. Description of lost certificates
 - (a) Name in which issued
 - (b) Numbers of certificates
 - (c) Total number of shares
 - (d) Were certificates indorsed?

or

Was power of attorney executed, providing for transfer of shares?
.....

If so, give details
.....

- 3. Is affiant the sole owner?
If not, give details as to actual ownership
.....

- 4. Have the certificates or any interest therein been pledged, hypothecated,

or otherwise transferred?

If so, give details

5. Give full details of loss, theft, or destruction, stating the date of the loss, theft, or destruction, the place where the certificates were kept, who had access to them, the time when the loss was discovered, the extent of the search that has been made, the amount of advertising, if any, that has been done, the steps that have been taken to recover the certificates, and all other pertinent information.

.....
Signature of affiant

Subscribed and sworn to before me this day of, 19.....

.....
Notary Public

(Affix notarial seal and county clerk's certificate showing
authority of notary public)

Form 818—Lost certificate bond.

KNOW ALL MEN BY THESE PRESENTS:

That, ..., of, as Principal (hereinafter called "Principal"), and, a corporation duly organized and validly existing under the laws of the State of, duly authorized to transact the business of indemnity and suretyship in the State of New York, and having an office and principal place of business in that State, at Street, ... City, as Surety (hereinafter called "Surety"), are now and forever held and firmly bound unto Corporation, ... corporation, and unto its Transfer Agent, and unto its Assistant Transfer Agent, and unto the Bank, a national banking association organized under the laws of the United States of America, its Registrar, and each of them, their respective successors, and assigns (hereinafter collectively called the "Obligees"), jointly and severally as their interests may appear, in an aggregate sum, lawful money of the United States of America, sufficient to indemnify the Obligees under the conditions of this bond as hereinafter set forth, but as to the Surety, not exceeding the maximum amount for which the Surety may obligate itself on the date of this bond in respect of any one risk or hazard under any law governing the validity or performance of this bond, which amount the Surety represents to be at least \$....., to be paid to the Obligees, for which payment, well and truly to be made, the Principal and Surety, and each of them, do bind themselves, and their and each of their respective

heirs, executors, administrators, successors, and assigns, jointly and severally, by these presents.

SEALED with the respective seals of the Principal and Surety, and executed in triplicate this day of, 19....

WHEREAS, the Obligees have heretofore issued, countersigned, and registered, to and in the name of, certificate or certificates numbered, representing shares of the common stock of Corporation; and

WHEREAS, the Principal represents and warrants that the Principal is the unqualified owner of said certificate or certificates and the stock represented thereby, and that the Principal has not pledged, hypothecated, or otherwise transferred any interest therein, and that no one other than the Principal has any right, title, or interest in or to said certificate or certificates of said stock; and

WHEREAS, the Principal further represents and warrants that said certificate or certificates have been lost, stolen, or destroyed and cannot be found or produced; and

WHEREAS, the Principal and Surety have requested the Obligees to issue, countersign, and register a new certificate or certificates to take the place of the certificate or certificates alleged to have been lost, stolen, or destroyed, and have promised to deliver said lost, stolen, or destroyed certificate or certificates, if found or produced, to the Obligees, to be cancelled, and have further promised to conduct any litigation relating to the aforesaid certificate or certificates, if so requested by any of the Obligees, and to indemnify and save harmless the Obligees; and

WHEREAS, in reliance upon the foregoing representations, warranties, and promises, the Obligees have issued, countersigned, and registered, or are about to issue, countersign, and register, said new certificate or certificates; and

WHEREAS, this obligation is now offered by the Principal and Surety to the Obligees as and for the promise and indemnity so required, the issuance, countersignature, and registration of said new certificate or certificates to constitute acceptance herof by the Obligees in the City of New York;

NOW, THEREFORE, the conditions of this obligation are: THAT, if the Principal and Surety, or either of them, or their respective heirs, executors, administrators, successors, or assigns shall, in case the above-mentioned lost, stolen, or destroyed certificate or certificates be found or recovered, deliver or cause the same to be delivered unto the Obligees in order to be cancelled; THAT, if the Principal and Surety, and each of them, or their respective heirs, executors, administrators, successors, or assigns, shall, if requested by the Obligees, or any of them, in case any litigation shall be instituted relating to said lost, stolen, or destroyed certificate or certificates or said new certificate or certificates, conduct such litigation on behalf of the Obligees at the sole expense of said Principal and Surety, and each of them, or of their respective heirs, executors, administrators, successors, or assigns; and THAT, if the Principal and Surety, and each of them, or their respective heirs, executors, administrators, successors, or assigns, shall also at all times indemnify and save harmless the Obligees, and each of them, from and against all claims, actions, and suits,

whether groundless or otherwise, and from and against any and all liabilities, losses, damages, costs, charges, counsel fees, and other expenses of every nature and character, arising out of, occasioned by, or in any manner growing out of the above-mentioned certificate or certificates alleged to have been lost, stolen, or destroyed and/or the issuance of said new certificate or certificates in lieu thereof, whether or not caused by, based upon, or arising out of inadvertence, accident, oversight, or neglect on the part of the Obligees, or any of them, or their respective officers, agents, clerks, or employees and/or omission or failure to inquire into, contest, or litigate the right of any applicant to receive any payment, credit, transfer, registration, conversion, exchange, issue, or delivery in respect of the original certificate or certificates and/or the new certificate or certificates issued in lieu thereof; THEN, and in such events, this obligation shall be void; OTHERWISE, it shall remain in full force and effect.

The Surety, furthermore, in consideration of its acceptance by the Obligees as a satisfactory surety hereon, hereby renounces all right which it may have under the statute law or the common law of the State of New York, or any other jurisdiction, to compel the Obligees, or any of them, upon any breach of this bond, to make any demand upon or take any action against the Principal before taking action against the Surety, and hereby agrees that forthwith upon any such breach, it shall be individually liable to the Obligees, and to each of them, as their interests may appear, for the full obligation of this bond, without notice of such breach and although no demand shall have been made upon and no action taken against the Principal; and the Surety further agrees that its liability hereunder shall be absolute, regardless of the fact that the Principal may not be liable hereunder.

The Principal and Surety, and each of them, hereby agree that this bond shall be deemed to be a New York contract and shall be governed as to all matters whatsoever, whether of validity, of interpretation, or otherwise, exclusively by the laws of the State of New York, and that all questions arising with respect thereto shall be determined in accordance with such laws.

The Principal and Surety, and each of them, hereby further agree to furnish to the Obligees, without any expense to the Obligees, a new bond of indemnity, which may differ from this bond in amount or in any other respect, with satisfactory surety or sureties, in case this obligation should not at any time, for any reason, in the opinion of the Obligees, or any of them, afford proper or sufficient protection to the Obligees, or any of them.

..... (L. S.)
(Individual) Principal

(Seal)
Attest:

.....
(Corporate Principal) Secretary

.....
(Corporation) Principal
By
President

.....
By
Surety
Vice-President
Attorney in Fact

(Seal)

Attest:

.....

(Surety) Secretary

(Surety acknowledgment)

State of } ss:
County of }

On this day of, 19...., before me personally appeared
....., to me known, who being by me duly sworn, did depose and say:
That he resides at Street, ... City, that he is
{ a Resident Vice-President }
{ an Attorney in Fact } of Corporation, the corporation
described in and which executed the foregoing instrument as Surety; that he
knows the corporate seal of said Corporation; that the seal affixed to said in-
strument is such corporate seal; that it was so affixed by order of the Board of
{ Directors }
{ Trustees } of said Corporataion; that he signed his name thereto by like
order; and that the liabilities of said Corporation do not exceed its assets as
ascertained in the manner provided by law. And said did
further say that he is acquainted with and knows him to be
{ a Resident Assistant Secretary }
{ an Attorney in Fact } of said Corporation; that the signature of
said, subscribed to said instrument, is in the genuine hand-
writing of said and was thereto subscribed by like order of
said Board of { Directors } and in the presence of him, the said
{ Trustees }

.....

Notary Public

(Affix notarial seal and county clerk's certificate showing authority of notary public)

(Individual acknowledgment)

State of } ss:
County of }

On this day of, 19...., before me personally appeared
.....
to me known and known to me to be the individual described in and who
executed the foregoing instrument, and thereupon he acknowledged to me
that he executed the same.

.....

Notary Public

(Affix notarial seal and county clerk's certificate showing authority of notary public)

(Corporate acknowledgment)

State of } ss:
County of }

On this day of, 19...., before me personally appeared
....., to me known, who being by me duly sworn, did depose

and say: That he resides at Street, ... City, that he is the President of Corporation, the corporation described in and which executed the foregoing instrument as Principal; that he knows the corporate seal of said Corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said Corporation; and that he signed his name thereto by like order; and on the same day and year before me personally appeared, to me known, who being by me duly sworn, did depose and say: That he resides at Street, ... City, that he is the Secretary of Corporation, the corporation described in and which executed the foregoing instrument as Principal; that he knows the corporate seal of said Corporation; that the seal affixed to said instrument is such corporate seal; that it was so affixed by order of the Board of Directors of said Corporation; and that he signed his name thereto by like order.

.....
Notary Public

(Affix notarial seal and county clerk's certificate showing authority of notary public)

[on back of form]

IMPORTANT INSTRUCTIONS

1. This bond should be executed by the owner of the original certificate or certificates (or, in the case of an estate or trust, by one who is beneficially interested therein) and by an acceptable surety company authorized to transact the business of indemnity and suretyship in the State of New York.
2. This bond must be executed in triplicate under the seals of the principal and surety; each counterpart must be acknowledged by both the principal and the surety before a notary public, and all blank spaces in all three counterparts must be properly filled in. It is essential that all three counterparts be alike in every respect.
3. Each notary public must affix his seal to each counterpart and state the date on which his commission expires. A certificate of the clerk or recorder of the county in which the bond is executed, showing the authority and certifying as to the genuineness of the signature of the notary public, should also be affixed to each of the three counterparts of the bond.
4. The insertion in this bond of a specific amount for which the surety may lawfully obligate itself on the date of this bond is for the purpose of complying with the requirements of any provision of the New York Insurance Law, or any similar law, limiting a company authorized to engage in the business of indemnity and suretyship from exposing itself to loss on any one risk or hazard in an amount exceeding a certain percentage of its capital and surplus.
5. There should be annexed to each counterpart of this bond a copy of the last available financial statement of the surety company. This copy should be certified by a proper officer of the surety company, and the certificate should set forth that the financial condition of the company is as favorable on the date of the execution of this bond as it was when said statement was made.

6. There should be annexed to each counterpart of this bond an extract from the by-laws, or a copy of a resolution or resolutions adopted by the board of directors of the surety company, or other appropriate evidence with respect to the authority of the attorney in fact or officer of the company executing the bond, certified by the proper officer or officers as being in full force and effect on the date of the execution of the bond; and in case of authorization given to the holder of a specified office, the proper officer or officers should also certify that the person executing the bond was the holder of such office on the said date. This certificate *must not be executed by any officer who executes this bond.*

7. If the principal is a corporation, evidence of the authority of the person executing the bond on behalf of the said corporation, similar to that required of the surety company, as set forth in (6) above, should be annexed to each counterpart of this bond.

Amount of bond. The usual practice in the case of preferred stock is to require a surety bond for twice its par value, or twice the market value if the stock is selling above par. This amount is based on twice the par or market value in order to cover any possible enhancement in the value of the stock and to cover legal and other expenses which might be incurred in the event of future complications arising from replacement. In the case of common stock, because wide fluctuations are not uncommon in such issues, an open indemnity bond is usually required, i.e., the bond does not specify a limit on the amount of loss recoverable.

Blanket bonds. Transfer agents may be authorized by a resolution similar to the one shown at Form 128 to use a blanket lost original instrument bond. Under the blanket indemnity bond plan, the affidavit of loss and indemnity agreement are combined in one form. The owner of the lost certificate is asked to send the transfer agent a check for the premium, made payable to the surety company. Where the blanket bond is not used, the stockholder makes his own personal application to a surety company for the bond and pays the premium directly to the surety company. This method involves more delay in replacing certificates than the blanket bond method. A resolution setting out these alternatives is shown at Form 127.

Procedure upon presentation of stock certificate for transfer during waiting period. As previously indicated, a corporation will not issue a duplicate certificate until a definite period has elapsed from the time that it first received notice of the loss. This period, is neces-

sary in order to give the stockholder an opportunity to locate his stock certificate. The issuance of a new certificate involves trouble and expense both to the stockholder and the corporation. Sometimes the lost certificate is presented for transfer during the waiting period. If this is the case, the transfer department immediately notifies the person who has presented the certificate that a stop transfer order has been entered against it, and notifies the original holder that the certificate has been presented for transfer. If the transfer otherwise appears to be in order, the original holder will be advised that, unless a bond is furnished by him within a fixed number of days (generally ten to thirty), indemnifying the corporation against loss for withholding transfer, the stop transfer order will be considered withdrawn, and the corporation will transfer the stock. In some corporations, a stockholder who has requested that transfer of his certificate of stock be stopped is immediately required to execute an affidavit as shown in Form 819, indemnifying the corporation against any loss which it may incur in stopping transfer of the stock, and agreeing to furnish a bond if the certificate is presented for transfer during the waiting period. Whether or not such an affidavit has been required, the stop transfer order is deemed withdrawn if the bond is not furnished within the prescribed number of days.

Form 819—Affidavit of indemnification and agreement to furnish bond upon presentation for transfer during waiting period.

To & Company
 Street
 City
 Fiscal and/or Transfer Agent of
 Corporation (here insert title of security)
 , 19....

			Shares or
No. of Security	Date of Issue	Issued in the Name of	Face Amount

....., the undersigned, does hereby certify that the security described above is the property of the undersigned and that it has been lost, mislaid, destroyed, or stolen under the following circumstances (if the security is registered, state whether it is indorsed or assigned):

It is hereby requested, if the hereinabove mentioned security should be presented for the purpose of transfer and/or payment, that you withhold such transfer and/or payment, and in consideration of such action by you, the undersigned agrees to indemnify you and/or et al., against all liability, costs, damages, or expenses, including counsel fees, which may be incurred by you by reason of the withholding of such transfer and/or payment or by reason of any action which you may take with respect thereto.

It is further agreed that, if said security should be presented for the purpose of transfer and/or payment, the undersigned will, immediately after the mailing of a request by you, deliver to you a bond in such form and with such sureties as are satisfactory to you, conditioned upon the indemnification of & Company et al., by the undersigned in the manner set forth above; and if such bond is not furnished by the undersigned, then this request to stop transfer and/or payment shall be deemed withdrawn.

It is further requested that the undersigned be advised in the event that said instrument is presented for transfer and/or payment. The undersigned, however, agrees that you shall not be under any liability for the transfer and/or payment of said security if the same should be presented, and trusts that you will use every reasonable effort to comply with the above request.

.....
Witness

.....
Principal

State of } ss:
County of

On this day of, 19...., before me personally came, to me known and known to me to be the same person described in and who executed the foregoing and acknowledged that he executed the same for the purpose named.

IN WITNESS WHEREOF, I have hereunto subscribed my name, and affixed my seal of office, the day and year last written above.

.....
Notary Public

Note: & Company will use every effort to comply with the request contained herein, but assumes no responsibility for the transfer of certificates upon which transfer has been stopped.

Court order for issuance of duplicate certificate of stock. Some corporations require a court order before they will issue a duplicate certificate. Form 820 is a copy of a letter explaining this practice. In such cases the stockholder or owner of the certificate applies to the court, setting forth the material facts concerning the loss. The court, after having been given satisfactory proof that the certificate was lost or destroyed, and cannot, after due diligence, be found, and that no sufficient cause has been shown why a new certificate should not be issued, serves an order upon the corporation, within a speci-

fied time, to issue and deliver to the petitioner a new certificate for the number of shares specified in the order. The applicant, however, must deposit in some public office designated by the court, such security or bond in such form and with such sureties as the court shall deem sufficient to indemnify the corporation or any person who shall thereafter be found to be the lawful owner of the certificate lost or destroyed. The board of directors then passes a resolution (Form 125) authorizing the officers of the corporation to issue the duplicate certificate as provided in the by-laws of the corporation, unless a blanket resolution (Form 127) authorizing such issuance has previously been passed.

Form 820—Letter explaining necessity for court order.

Dear Sir (or Madam):

As a result of your letter of , advising us of the loss of your certificate(s) No.(s) , for share(s) of the preferred stock of this Company, we have notified the Transfer Agent of this Company, ... Corporation, ... Street, ... City, of your statement, and have requested the Transfer Agent to enter a stop order against the transfer of this/these certificate(s), should it/they be presented for such purpose.

It is, of course, always possible that a lost certificate may be found, and we hope you will promptly notify us if yours turns up. As long as the certificate(s) stand(s) in your name on the books of the Company, checks for dividends declared in respect of this/these share(s) will be mailed to you.

Provision is made under Sections and of the Stock Corporation Law of the State of , for the issuance of a new certificate, upon the order of the Supreme Court, in place of a lost or destroyed certificate of stock. If such an application to the Supreme Court is made by you, counsel for this Company is instructed to waive any formalities concerning the service of the papers, and voluntarily to appear before the court in regard to the matter.

Very truly yours,
.....

Lost certificate file. Many transfer departments file all correspondence pertaining to lost certificates in their regular correspondence file after the proper notices have been sent out and stop transfer records made. Others keep all correspondence and documents covering the lost certificates in a separate alphabetical file, arranged according to the name of the stockholder. The papers are placed in

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individual envelopes, which bear on their face the entire history of the lost certificate, as shown in Form 821. Indemnity bonds are often kept in vaults, rather than in the department files.

LOST COMMON STOCK CERTIFICATE		
Certificate No. _____	Date of Issue _____	Number of Shares _____
Certificate Registered in the Name of } _____ } _____ } _____		Date Loss Reported
Loss of Certificate Recorded	Recovery of Certificate Recorded	REMARKS
Stock Division _____	Stock Division _____	
Registrar _____	Registrar _____	
Authorization Received from Board of Directors to Issue Substitute Certificate _____		
Affidavit Executed _____ Bonds of Indemnity _____ Name _____ Date _____ Approved by Counsel _____ Date _____ Bond Accepted _____	Substitute Certificate Issued Certificate No. _____ Date _____ Number of Shares _____	Registrar Notified _____ _____ Bond of Indemnity Returned by Registrar _____ Date _____

Form 821—Lost certificate envelope.

Entries in transfer records. The issuance of a new certificate of stock in place of a lost certificate must be recorded on the transfer sheet, in the stock ledger, and in a special account called "Lost Certificate account." The following entries will be made on the transfer sheet (see Form 782):

Under "Certificates Surrendered"

Name of stockholder; Number of certificate lost; Number of shares.

Lost Stock account—Name of stockholder; New certificate number; Number of shares.

Under "Certificates Issued"

Lost Stock account—Name of stockholder; Number of certificate lost; Number of shares.

Name of stockholder; New certificate number; Number of shares.

When these entries have been posted, the Lost Stock account will show on the debit side the new certificate issued, and on the credit side, the old certificate lost. The stockholder's ledger account will show on the credit side the old certificate originally issued and the new certificate issued to replace the certificate lost. On the debit side it will show the old certificate lost.

Procedure where lost certificate is presented for transfer after issuance of duplicate certificate. Corporations keep a stop transfer order on a lost certificate for an indefinite period after a new certificate has been issued and the bond of indemnity furnished. If the old certificate is presented for transfer, the corporation will retain the certificate and immediately notify the person who presented it that a stop order is pending against it and that a duplicate certificate has been issued. It will also notify the surety company which furnished the bond upon issuance of the duplicate stock certificate. The surety company will notify the original holder of the certificate and will make an investigation to determine the rights of the respective claimants. If the holder of the old certificate of stock is actually a bona fide holder, entitled to the transfer, the surety company will either have to settle his claim, or, if he insists upon transfer of his stock, the surety company will have to reimburse the corporation for its loss under the terms of the bond. In no event can a lost certificate which has been replaced be transferred, as that would create an over-issue. Therefore the surety company may have to go into the open market and purchase an equivalent number of shares so that the transfer can be made. If the surety company contends that the holder is not bona fide and the corporation is sued for refusal to effect the transfer, the surety company will be required to protect the corporation under the terms of the bond.

Procedure where lost certificate is found by original stockholder after issuance of duplicate certificate. After a duplicate certificate of stock has been issued, it sometimes happens that the stockholder finds the old certificate of stock. Upon notifying the corporation that it has been found, the stockholder will be requested to turn in the original certificate of stock and will, upon presentation, be given a receipt for it. The stop transfer order will be removed from the

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records of the transfer department, and notice of the removal will be given to the registrar and any person who had been notified of the stop transfer. The transfer agent will also notify the surety company that the original certificate was found and presented for cancellation. The surety bond may be returned to the stockholder if the certificate is found within six months so that he may obtain a refund of part of the premium. On the face of the original certificate will appear a notation of its history. The certificate will be duly cancelled by the transfer agent and will also be sent to the registrar for cancellation. Upon its return by the registrar, it will be placed with other cancelled certificates in the cancelled certificate file.

CHAPTER 26

LEGAL PRINCIPLES GOVERNING DIVIDENDS

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Legal Principles Governing Dividends

Definition of a dividend. A dividend is that portion of the profits and surplus funds of a corporation that has actually been set aside by a valid act of the corporation for distribution among the stockholders of record on a fixed day, in proportion to their holdings, to be paid on demand or at a fixed time.¹

Who may declare a dividend. The declaration of a dividend and the fixing of the amount, time, and terms of payment rest generally in the discretion of the board of directors,² acting in good faith.³ This general rule is, however, subject to the following exceptions: (1) a statute may limit or control the action of the board; (2) the corporate charter, the by-laws, or some other governing instrument or contract may either place an obligation on the board of directors to declare a dividend, or may limit its power to do so.⁴ Ordinarily stockholders have no right to declare dividends.⁵ However, it has been held that the stockholders may informally agree to distribute a certain sum as profits without taking any formal action, or without action of the board of directors. If all the stockholders agree, and no creditor or other third party is prejudiced, the agreement is a valid declaration of a dividend.⁶ Under some statutes, however, the stockholders, even if they agree unanimously and take formal action at a

¹ *State v. Nebraska State Bank of O'Neill*, (1932) 123 Neb. 289, 242 N.W. 613; *Gable v. South Carolina Tax Comm'n*, (1939) 189 S.C. 346, 1 S.E.(2d) 244.

² *Schuckman v. Rubenstein*, (1948) 164 F.(2d) 952, cert. denied, 333 U.S. 875, 68 S. Ct. 905; *Richter & Co. v. Light*, (1922) 97 Conn. 364, 116 A. 600. But see *Maloney v. Western Cooperage Co.*, (1939) 103 F.(2d) 992, in which the authority of the board of directors to declare dividends was delegated to the secretary-treasurer.

³ *Leviton v. North Jersey Holding Co.*, (1930) 106 N.J. Eq. 517, 151 A. 389; *Lindgrove v. Schluter & Co.*, (1931) 256 N.Y. 439, 176 N.E. 832.

⁴ *Lydia E. Pinkham Medicine Co. v. Govc*, (1939) 303 Mass. 1, 20 N.E.(2d) 482; *Patterson v. Durham Hosiery Mills*, (1939) 214 N.C. 806, 200 S.E. 907; *Morrison v. State Bank*, (1942) 58 Wyo. 138, 126 P.(2d) 793.

⁵ *Milligan v. G. D. Milligan Grocer Co.*, (1921) 207 Mo. App. 472, 233 S.W. 506.

⁶ *Kearneysville Creamery Co. v. American Creamery Co.*, (1927) 103 W. Va. 259, 137 S.E. 217, citing *Barnes v. Spencer & Barnes Co.*, (1910) 162 Mich. 509, 127 N.W. 752, and other cases.

legal meeting of stockholders, cannot declare a dividend and enforce its payment without the consent of the board of directors.⁷ A declaration of a dividend by stockholders who are powerless to declare dividends may be ratified by the board of directors, which has the authority in the first instance to declare a dividend.⁸

Necessity for formal declaration of dividend. The action of the directors in declaring a dividend does not necessarily have to be taken by formal resolution at a directors' meeting, unless the statute, charter, or by-laws so provide.⁹ The courts have frequently held that dividends were in fact declared when no formal meeting of the board had been held and no record was made of the declaration.¹⁰ From the standpoint of expediency, however, it is well to take formal action in the declaration of dividends by adopting, at a meeting of the board of directors, a carefully drawn resolution, indicating: (1) the amount of the dividend; (2) the classes of stockholders to whom the dividend is payable; (3) the record date for determining who is entitled to the dividend; (4) the date when the dividend will be paid; and (5) the medium of payment.¹¹

The amount of the dividend is sometimes stated as so much per share to holders of certain classes of stock. Sometimes, however, in inter-corporate relations, a dividend may be declared merely as a lump sum. This is particularly true when the declaring corporation

⁷ *Milligan v. G. D. Milligan Grocer Co.*, supra (Note 5).

⁸ Ratification by the board may be shown without any formal action by the directors, as, for example, by a payment of the dividend by the directors. *Milligan v. G. D. Milligan Grocer Co.*, supra (Note 5).

⁹ *Fidelity & Columbia Trust Co. v. Louisville Ry.*, (1936) 265 Ky. 820, 97 S.W.(2d) 825; *Groh's Sons v. Groh*, (1903) 80 App. Div. 85, 80 N.Y. Supp. 438. See also *Van Dyck v. McQuade*, (1881) 86 N.Y. 38, in which the court held that the trustees could not avoid liability because a vote was not taken and recorded as prescribed by statute. The statutory provision was for the benefit of the trustee, and, while he could waive the direction, he could not take advantage of the omission.

¹⁰ *Atherton v. Beaman*, (1920) 264 F. 878, aff'g (1919) 256 F. 871. See also *Southwestern, A. & I. T. Ry. v. Martin*, (1893) 57 Ark. 355, 21 S.W. 465.

¹¹ In *English & Mersick Co. v. Eaton*, (1924) 299 F. 646, a tax case, the court said: "It is of course unnecessary to employ some particular terminology in order to declare a dividend. On the other hand, neither the Government nor the corporation is necessarily bound or concluded by the language of the resolution in the ascertainment of corporate intent. For instance, when surplus has in fact been distributed, the Government will not be bound by a declaration of the corporation that said division of surplus constitutes a salary payment. . . . Reason and justice would therefore seem to indicate that the converse of that proposition should also be true and that, where surplus has not in fact been divided, it should not be regarded as a dividend at law."

is a wholly owned subsidiary of the receiving corporation and there is no necessity for showing the dividend rate per share since the parent will receive the entire amount.

The minutes of the action taken in declaring the dividend should clearly indicate who was present at the time and who voted against passage.¹²

➤➤➤**WARNING**➔ Numerous statutes and regulations provide, in one form or another, that the payment of salaries to officers of a corporation in direct proportion to their stock holdings is deemed the declaration of a dividend. When, in fact, the corporation is actually an incorporated partnership and the stockholders are the active working participants in business activity, it is wise to have a definite resolution outlining the duties of each officer who holds a substantial percentage of the stock. The purpose of this resolution is to indicate that compensation results from work performed for the benefit of the corporation and not merely as an attribute of stock ownership.

Advantages of formal declaration of dividend. Declaration of a dividend by means of formal action, as indicated in the preceding paragraph, has the following distinct advantages: (1) the rights of all persons to the dividend are defined, and the possibility of dispute between the holders and their transferees and between the corporation and the stockholders is minimized; (2) directors are given an opportunity to look into the legality of the dividend; (3) those who oppose the declaration of the dividend may indicate their dissent at the meeting and, in the presence of the assenting directors, may request their opposition to be entered in the minutes; (4) the record furnishes evidence in suits between the corporation and the stockholders of what was done in regard to the dividend;¹³ (5) the possibility that the dividend will be declared invalid because no formal action was taken or recorded is avoided;¹⁴ and (6) tax disputes may be avoided if dividends are formally declared.¹⁵

Necessity for surplus or profits before declaration of dividend. The general rule is that a dividend in a going concern may be de-

¹² Directors who oppose the dividend should see to it that their dissent is noted in the minutes. Those who are not present, but dissent from the action, should so inform the board immediately upon learning of it. See p. 1166.

¹³ Minutes of corporate meetings are prima facie evidence of business transacted at the meeting. *Kelly-Koett Mfg. Co. v. Goldenberg*, (1924) 94 Pa. Super. Ct. 145.

¹⁴ See *American Wire Nail Co. v. Gedge*, (1895) 96 Ky. 513, 29 S.W. 353, in which one of the questions to be determined was whether a dividend had, in fact, been declared.

¹⁵ See 23 MINN. L. REV. 831, discussing *United States v. Southwestern Portland Cement Co.*, (1938) 97 F.(2d) 413.

clared and paid out of profits or surplus only, and not out of capital of the corporation. This rule applies even in the absence of any statute on the subject.¹⁶ In most states, some statutory provision is found expressing the rule. The statutes vary in their terminology, but in substance they provide that the corporation may not declare a dividend if it will impair the capital stock, or if there are no assets or surplus out of which the dividend can be paid.¹⁷

Thus, some of the statutes provide that "dividends may be made from the corporate net earnings or from the surplus of assets over liabilities, including capital stock"; that "directors shall not make dividends except from surplus profits arising from the business"; that "all dividends must be declared and paid from the earned surplus which is founded upon actual earnings or net profits"; and that "no dividend shall be paid while the corporation is insolvent or that will render the corporation insolvent."

The first problem of the directors in considering the declaration of a dividend is to determine whether surplus or net earnings legally applicable to the payment of dividends exist. If the surplus does exist, the directors can then decide whether, from the standpoint of financial policy, it is expedient to use that surplus or earnings for dividends. Until a corporation pays, or provides for the payment of, its debts, it cannot lawfully declare dividends.¹⁸

Problems in determining whether surplus or profits exist legally for payment of dividends.¹⁹ In determining whether surplus or profits exist legally for the payment of dividends, it is necessary to examine carefully the governing state statute and the interpretation

¹⁶ *Mobile & O. R.R. v. Tennessee*, (1894) 153 U.S. 486, 14 S. Ct. 968; *Davenport v. Lines*, (1899) 72 Conn. 118, 44 A. 17. See also *Levin v. Pittsburgh United Corp.*, (1938) 330 Pa. 457, 199 A. 332; *Baker v. Mut. Loan & Inv. Co.*, (1948) 213 S.C. 558, 50 S.E.(2d) 692.

For the origin of the restriction against declaration of dividends out of capital, see Kehl, "The Origin and Early Development of American Dividend Law," 53 HARV. L. REV. 36.

¹⁷ *Beneficial Corp. v. Reading & Southwestern St. Ry.*, (1950) 91 F. Supp. 803; *Webb City Undertaking Co. v. Sinclair*, (1949) 240 Mo. App. 683, 225 S.W.(2d) 138.

¹⁸ *Seaboard Ice Co. v. United States*, (1945) 60 F. Supp. 879, citing *FLETCHER, CORPORATIONS*, §5340.

¹⁹ For consideration of the problem of surplus from a financial point of view, see *Corliss v. United States*, (1925) 7 F.(2d) 455; *Brooks Equipment Co. v. United States* (1951) 95 F. Supp. 247; *People ex rel. Jamaica Water Supply Co. v. State Board of Tax Comm'rs*, (1908) 128 App. Div. 13, 112 N.Y. Supp. 392; *Towles v. South Carolina Produce Ass'n*, (1938) 187 S.C. 290, 197 S.E. 305.

of that statute by the local courts.²⁰ Though recent statutes tend to give a more detailed definition of surplus, the problem has become very complicated, especially where several classes of stock without par value are concerned.²¹ Not only do the provisions of the statutes vary throughout the country, but various interpretations of similarly worded statutes have been made in different states. The problems most likely to arise in determining whether surplus exists legally are: (1) Must capital stock be taken at its par value, or may it be taken at the actual value received upon the sale of the par value stock? (2) How shall the directors arrive at the amount of capital represented by stock without par value? (3) What other items, if any, must be considered as capital liabilities in arriving at surplus or net profits?

No definite rules can be given as a guide for directors in determining whether or not surplus or net profits legally exist. It is possible only to show the various ways in which surplus has been determined by the courts, and to advise directors that, if the question of the legality of a dividend arises, the court will base its decision on the statutes of the state in which the corporation is organized.²²

Methods of determining legal existence of surplus or profits.

The examples given below indicate various ways in which the courts have determined whether surplus or net profits exist for the payment of dividends. As indicated in the preceding paragraph, the method to be used by a particular corporation will depend upon the local law.

Stock taken at par value. A legal surplus exists when there is an excess in the aggregate value of all assets of a corporation over the sum of its liabilities, including capital stock at its par value. In other words, dividends may be paid out of net profits only, or, conversely stated, when the payment does not impair the capital stock of the corporation.²³ Thus, if a corporation's balance sheet shows

²⁰ See Kreidmann, "Dividends—Changing Patterns," 57 COLUM. L. REV. 372.

²¹ See "Determination of capital and surplus represented by stock without par value" on page 1120.

²² National Lock Co. v. Hogland, (1939) 101 F.(2d) 576; Lich v. United States Rubber Co., (1941) 39 F. Supp. 675, aff'd, memo dec., 133 F.(2d) 145.

²³ Cox v. Leahy, (1924) 209 App. Div. 313, 204 N.Y. Supp. 741; Branch v. Kaiser, (1928) 291 Pa. 543, 140 A. 498; Towles v. South Carolina Produce Ass'n, (1938) 187 S.C. 290, 197 S.E. 305.

assets accurately valued at \$100,000, capital stock outstanding, having a par value of \$50,000, and liabilities of \$20,000, the corporation has a surplus of \$30,000, which, in the discretion of the directors, may be distributed to the stockholders as dividends.

Stock taken at actual value received from sale. A legal surplus exists when there is an excess in the aggregate value of all assets of a corporation over the sum of its entire liabilities, including capital stock not at its par value, but at the actual value received from the sale of the stock.²⁴ Thus, if a corporation has issued and outstanding par value stock in the amount of \$3,000,000 from the sale of which it has realized an actual value of but \$1,700,000, and its assets amount to \$2,500,000 and its liabilities to \$300,000, the corporation has a surplus of \$500,000 available for dividends. Under this method of determining surplus, a distinction is made between capital and capital stock. The capital of the corporation, which is the amount received by it from the sale of its stock, will not be impaired by the distribution of \$500,000, for, after the payment of the dividend, there will remain net assets equal to the amount realized upon the sale of the stock.

Determination of capital and surplus represented by stock without par value. The determination of what constitutes capital and what constitutes surplus in a corporation having shares without par value, depends upon the provisions of the statutes permitting the issuance of shares without par value and upon the provisions of the statutes relating to the payment of dividends. In each case where these questions are to be determined, such statutes should be consulted. To aid in the solution of these difficulties, a classification of the statutes on the basis of their provisions as to capital is made as shown below.²⁵

Capital is the amount of consideration received for no-par shares. Some of the statutes state that the capital represented by the no-par shares shall be the amount of money or consideration received for the shares. To determine the surplus in such a case, the directors

²⁴ *Peters v. United States Mortgage Co.*, (1921) 13 Del. Ch. 11, 114 A. 598; *Goodnow v. American Writing Paper Co.*, (1907) 73 N.J. Eq. 692, 69 A. 1014.

²⁵ For a fuller consideration of the problems involved in no-par shares, see *Israels*, "Problems of Par and No-Par Shares: A Reappraisal," 47 COLUM. L. REV. 1279.

have a no more difficult problem than they would have if the stock had par value. If the corporation has assets of \$500,000, par value stock outstanding in the amount of \$200,000, no-par stock outstanding for which the corporation has received \$110,000, and liabilities of \$20,000, the corporate surplus is \$170,000.

Directors to determine portion of consideration to be treated as capital. In several of the states the statutes permit the board of directors to determine by resolution what portion of the consideration received for no-par value shares shall be treated as capital. In this case, the capital stock account on the books of the corporation shows the amount that the corporation considers as capital, and an account called "Paid-in Surplus" is credited with the difference between that amount and the consideration received for the stock. Transfers made to the capital account from time to time by resolution of the directors must be added, of course, to the amount originally regarded as capital.²⁶

No-par shares required to have stated value, but no statutory provisions for determination of capital. In a few states the statutes require the corporation to give each share of no-par value stock a stated value in the articles of incorporation, but contain no provision as to how capital is to be determined. To ascertain the surplus in this case, the directors are justified in considering as the capital representing the no-par stock, the number of shares issued and outstanding, multiplied by the stated value per share. They are justified in considering this amount as capital since the incorporators agreed to such an amount when they signed the articles of incorporation and since subscribers and others, including creditors, are chargeable with notice thereof through filing of the articles.

Option of directors to treat stated value or consideration received for shares as capital. A few of the statutes give directors a choice of one of the following methods of determining capital:

1. A stated value must be placed in the certificate of incorporation upon each no-par share, and the corporation must regard as capital the aggregate par value of all issued shares having par value, plus the aggregate value of the no-par shares calculated at the stated value

²⁶ *Armentrout v. Armentrout*, (1951) (Ohio) 100 N.E.(2d) 555.

per share, plus such amounts as the board of directors may, from time to time, transfer to capital, by resolution. The statute indicates the minimum stated value per share.

2. No stated value need be placed upon each no-par share. The capital of the corporation is the aggregate par value of all the issued shares having par value, plus the aggregate amount of consideration received by the corporation for the issued shares without par value, plus such amounts as the board of directors transfers to capital from time to time, by resolution.

No provision in the statute for the determination of capital, and no stated value required. In some instances the statutes do not indicate how capital shall be determined and do not require that a stated value be given, in the articles of incorporation, to each share of no-par value stock. In such cases the question arises as to what part of the consideration received for no-par shares must be regarded as capital. It cannot be said that the amount indicated in the articles of incorporation as the capital with which the corporation will begin business is the capital of the corporation represented by the no-par shares. Obviously, a corporation that has indicated the sum of \$1,000 in its articles of incorporation as the amount of capital with which it will begin business, and which has sold no par value shares for \$100,000, would not be justified in considering \$1,000 as its capital. In the absence of some different arrangement, clearly stated to the purchasers of the stock at the time of the issuance of stock without par value, the corporation should regard as capital the full consideration received upon the sale of the no-par shares. It would be unfair to investors if any other method were followed, since purchasers of stock, in the absence of statutory, charter, or contract provision to the contrary, assume that whatever has been paid for their stock will be used by the corporation in carrying on its business, and that none of the consideration will be treated as surplus available for dividends.

Sources of surplus legally available for dividends. The following paragraphs explain the availability of various sources of surplus for dividends, from a legal standpoint.

Increase in value of assets. Whether an increase in surplus due to

an increase in the value of assets is available for dividends depends upon the statute of the state in which the corporation is organized.²⁷ If the statute permits dividends to be declared from "surplus," as distinguished from "net earnings," it is not important how the surplus is acquired, and an increase due to an enhancement in the value of the assets is a proper source for dividends.²⁸ The surplus, however, must be bona fide and not fictitious. Thus, unjustified "write-ups" in the value of fixed assets are not realized appreciation of assets and cannot be included in determining surplus.²⁹ If the statute permits a declaration of dividends only from "net profits arising from the business," an estimated increase in the value of a building owned by the corporation would not be a proper source of dividends.³⁰ Nor in such case would an increase in the market price of the corporation's inventories be a proper source of surplus for dividends until such profits had actually been realized by a sale of the inventories.³¹

Accrued interest. A corporation may not consider as available for dividends, interest that has matured upon a loan made by the corporation, but that has not been paid, regardless of how certain the corporation is to collect the amount.³²

Estimated profits on partially executed contracts. A corporation may not regard estimated profits on partially executed contracts as profits available for dividends.³³

Profit from sale of capital assets. Unless the corporation is in liquidation, profit from the sale of a capital asset may enter into the earning or surplus account and is a proper source of dividends.³⁴

Premium upon sale of stock. The courts are not in agreement as

²⁷ See Ballantine & Hills, "Corporate Capital and Restrictions upon Dividends under Modern Corporation Laws," 23 CALIF. L. REV. 229.

²⁸ See *Randall v. Bailey*, (1942) 288 N.Y. 280, 43 N.E.(2d) 43, quoting from *Edwards v. Douglas*, (1925) 269 U.S. 204, 46 S. Ct. 85.

²⁹ *Berks Broadcasting Co. v. Craumer*, (1947) 356 Pa. 620, 52 A.(2d) 571.

³⁰ *Kingston v. Home Life Ins. Co.*, (1917) 11 Del. Ch. 428, 101 A. 898. The Delaware statute has since been amended.

³¹ *Southern California Home Builders v. Young*, (1920) 45 Cal. App. 679, 188 P. 586; *Sexton v. C. L. Percival Co.*, (1920) 189 Iowa 586, 177 N.W. 83; *Irving Trust Co. v. Gunder*, (1934) 152 N.Y. Misc. 83, 271 N.Y. Supp. 795.

³² *Southern California Home Builders v. Young*, *supra* (Note 31).

³³ *Ibid.*

³⁴ *Adams v. Whitmarsh*, (1941) 66 R.I. 53, 17 A.(2d) 433, citing 18 C.J.S. 1101, *Corporations* §462.

to the availability of premiums received upon the sale of capital stock for distribution as dividends. It has been held in some states that the amount of the premium may be treated as profits.³⁵ A California court, on the other hand, has held that the entire proceeds of the sale of stock, even when sold for more than par, are part of the capital stock and, therefore, cannot be considered as profits earned through the conduct of business out of which dividends may be paid.³⁶ It would seem certain that if such a premium were used to pay dividends, and if the conditions under which the new stock was sold led purchasers to believe that they were buying "dividend earning" stock, they could claim that they had been defrauded.

The profit produced by a corporation's purchase of its own stock and resale at a high price, is available for dividend distribution.³⁷

Surplus after reduction of capital stock. Upon the legal reduction of capital stock, the corporation may distribute in dividends the excess of its assets over the total of debts plus the amount to which the capital stock has been reduced.³⁸ Resort to this expedient to create a surplus for dividends is not uncommon in times of declining security values and reduced earnings. In states where the source of the dividend is not limited by statute to net earnings or profits, a reduction of stock liability to create or to increase surplus may usually be accomplished in one of the four following ways:

1. By requesting each stockholder to surrender a percentage of his shares for cancellation.
2. By reducing the par value of each share of stock.
3. By changing par value stock to no-par and prescribing for the latter a smaller stated value than the par value of the former.
4. By reducing the stated value of stock without par value.

Profits upon sale of stock of other corporations. Such a profit is available for dividends.³⁹

³⁵ *Graham v. Louisville Transit Co.*, (1951) (Ky.) 243 S.W.(2d) 1019; *Smith v. Cotting*, (1918) 231 Mass. 42, 120 N.E. 177.

³⁶ *Merchants' & Insurers' Reporting Co. v. Youtz*, (1918) 39 Cal. App. 226, 178 P. 540.

³⁷ *National Newark & Essex Banking Co. v. Durant Motor Co.*, (1938) 124 N.J. Eq. 213, 1 A.(2d) 316.

³⁸ *Dominguez Land Corporation v. Daugherty*, (1925) 196 Cal. 468, 238 P. 703; *Graham v. Louisville Transit Co.*, *supra* (Note 35); *Roberts v. Roberts-Wicks Co.*, (1906) 184 N.Y. 257, 77 N.E. 13; *Strong v. Brooklyn, etc. R.R.*, (1883) 93 N.Y. 426.

³⁹ *Equitable Life Assurance Soc'y v. Union Pac. R.R.*, (1914) 212 N.Y. 360, 106 N.E. 92.

Forfeited stock. It has been held that the amount of money received by a corporation for shares of stock that have been forfeited because of nonpayment of calls does not constitute a profit out of which the corporation may declare dividends.⁴⁰ It would seem that if the corporation reissued the shares that had been forfeited and received in payment a sum which, together with the amount paid by the original holder, less the costs involved in the forfeiture, exceeded the par value of the shares, the corporation could treat the excess in the same manner as it would a premium received upon the sale of stock.⁴¹

Settlement of debt at a discount. It has been held that if a debt was incurred as an operating expense, its settlement, for a lesser amount, produces a profit available for dividends. But compromise of a lien that encumbered the corporation's property at the time it was acquired, or of any obligation incurred for capital purposes, does not result in a surplus.⁴²

Payment of dividends from accumulations of surplus or current earnings. From a legal standpoint, as distinguished from the standpoint of financial expediency, the directors, in order to determine whether a surplus is available for dividends, in the absence of statutory, charter, or contract provisions requiring dividends to be paid from current earnings, may disregard the profit and loss statement, that is, the statement showing earnings for the current year, and may study only the balance sheet. The balance sheet shows the accumulation of past as well as current earnings up to the time as of which the balance sheet is made up. Dividends may be paid from a surplus resulting from current earnings or from accumulated surplus.⁴³ For this reason dividends may be lawfully declared out of surplus ac-

⁴⁰ Gratz v. Redd, (1843) 4 B. Mon. (Ky.) 178.

⁴¹ In Gratz v. Redd, *supra* (Note 40), the court said: "Had a sale been made of the [forfeited] stock and had it commanded a price, substituting the purchasers in the place of the former stockholders, the amount bid might have been carried to profits; or, had a fair estimated value been fixed upon it, and that estimated value exceeded its par value, including the sum paid on it, that excess, perhaps, might have been carried to profits."

⁴² National Newark & Essex Banking Co. v. Durant Motor Co., *supra* (Note 37).

⁴³ Lynch v. Hornby, (1918) 247 U.S. 339, 38 S. Ct. 543; Moran v. U.S. Cast Iron Pipe & Foundry Co., (1924) 95 N.J. Eq. 389, 123 A. 546, *aff'd* 96 N.J. Eq. 698, 126 A. 329. See Lich v. United States Rubber Co., *supra* (Note 22) for distinction between net profits and annual net earnings.

accumulated from the profits of previous years, even if there is no profit for the period in which the dividend is paid.⁴⁴ A company that, for a number of years, had accumulated profits and had retained them as working capital and as funds for creating greater security for the payment of dividends and for the protection of the company's credit, was held to be making a valid distribution of profits when it declared dividends on the common stock from the accumulation.⁴⁵ Also, undistributed surplus that has been invested in physical assets may be withdrawn and distributed as dividends.⁴⁶

Determining current profits—treatment of expenditures. In determining profits for the current year, the net results of the year's operations will depend upon whether items of expenditures have been capitalized or charged to profit and loss. For example, if an expenditure of \$5,000 upon a machine that is to last two years, is treated as an asset, the profit for the period will be \$5,000 (less whatever amount is deducted for depreciation) more than it would be if the expenditure were charged as an expense. Expenditures chargeable to earnings include the general expenses of keeping up the organization of the company and all expenses incurred in operating the business and in keeping its property in good repair; whereas expenses chargeable to capital include those that are incurred in the original acquisition of the business and in the enlargement and improvement of it.⁴⁷ The manner of treating expenditures is left to the discretion of the directors, but frequently, as in the case of railroads and public utilities, the procedure is prescribed by statute or by rules adopted by some regulating body. To determine current profits, there must be deducted from the income the total of the operating expenses, fixed charges such as interest on bonded indebtedness, taxes, depreciation,⁴⁸ and costs of maintenance and upkeep.⁴⁹

⁴⁴ *Murray v. Beattie Mfg. Co.*, (1912) 79 N.J. Eq. 322, 82 A. 1038.

⁴⁵ *Colorado ex rel. Fraser v. Great Western Sugar Co.*, (1929) 29 F.(2d) 810.

⁴⁶ *National Lock Co. v. Hogland*, *supra* (Note 22).

⁴⁷ See *Union Pac. R.R. v. United States*, (1878) 99 U.S. 402; *U.S. v. Kansas Pac. Ry.*, (1878) 99 U.S. 455.

⁴⁸ *Krull v. Pierce*, (1947) 17 Ind. App. 638, 71 N.E.(2d) 617; *People ex rel. Binghamton Light, Heat & Power Co. v. Stevens*, (1911) 203 N.Y. 7, 96 N.E. 114; *Mayer v. Renner Co.*, (1951) (Ohio App.), 109 N.E.(2d) 573.

⁴⁹ *Corliss v. United States*, *supra* (Note 19); *People ex rel. Jamaica Water Supply Co. v. State Board of Tax Comm'rs*, (1908) 128 App. Div. 13, 112 N.Y. Supp. 392.

Analysis of assets to determine if a surplus available for dividends really exists. Ordinarily the court will not substitute its view of valuation for that of the directors if the directors' valuation of assets for dividend purposes is based on acceptable data and standards which reasonably reflect present value.⁵⁰ But a court may look behind the values of the assets as they appear on the books of the corporation to determine whether a surplus really existed for the payment of dividends,⁵¹ or whether the corporation impaired its capital in the distribution of a dividend. If the courts were not permitted to do this, the directors could confer upon themselves the power to declare dividends out of capital by valuing the assets above their actual worth.⁵² Each item on the assets side of the balance sheet should therefore be studied individually in arriving at the amount available for dividends, in order that assets which have a doubtful existence may be eliminated. Among the assets, for example, may be such fictitious items as "bond discount," "organization expenses," "deferred charges to expense," and similar capitalized expenditures. As to the assets that have an undoubted existence, the directors must ask themselves, "Does the value of the assets as they are carried on the books represent their present value?" The fixed assets must be examined to see that proper depreciation has been deducted and that the items are not carried at amounts representing estimated increases in the value of the physical property. The receivables must be examined to see if the figure at which they are carried represents the amount of collectible debts. The working assets, such as raw materials, materials in process, and finished products must be scrutinized to see that the inventories do not include nonusable or unsalable goods. The outlook for prices of materials used by the corporation must also be considered in judging the value of assets shown on the balance sheet. For example, in times of falling prices, inventory values fall, and surplus diminishes accordingly. Assets such as patents, copyrights, and publishers' plates should not be carried at large values by a concern that makes any pretense of conservatism. A patent may lose its value in a short period because of changes in fashion, competition with

⁵⁰ *Morris v. Standard Gas & Elec. Co.*, (1949) 31 Del. Ch. 20, 63 A.(2d) 577.

⁵¹ See *Gallagher v. New York Dock Co.*, (1940) 19 N.Y.S.(2d) 789.

⁵² *Siegmán v. Electric Vehicle Co.*, (1907) 72 N.J. Eq. 403, 65 A. 910.

other inventions, or similar causes. This leads us to the question of what reserves should be set up.

Reserves to be set up. A list of the reserves that a corporation may find necessary or expedient to set up is given below:

1. Depreciation reserves.
2. Reserve for bad debts.
3. Obligation reserves, such as reserves for taxes and reserves to protect sinking funds set aside to redeem obligations at maturity.
4. Insurance, welfare, and pension reserves.
5. Dividend equalization reserves.

This list of reserves may be grouped into: (1) operating reserves, which provide for some expense or future loss to be sustained; and (2) nonoperating reserves, such as sinking fund reserves, which are created for specific purposes. The difference between the two classes of reserves is that those belonging to the first group represent a reduction of profit while those in the second indicate a setting aside of profits. The operating reserves rarely find their way back into profits, while the nonoperating reserves may. Thus, after a series of bonds have matured and are paid off, the reserve for sinking fund is transferred to surplus and is available for dividends.

Secret reserves. Frequently, through a desire to present the accounts of the company in the most conservative way, secret reserves are created. These may be built up in the following ways: (1) valuing assets at less than their actual value; (2) writing off assets that exist and have value; (3) charging to expense items that may be charged to the capital account; (4) setting up liabilities at amounts in excess of their actual figure; (5) setting up liabilities that do not exist; and (6) setting up reserves, for any purpose, that are larger than the purpose demands.

The harm done by creating hidden reserves is that stockholders are likely to sell their shares for amounts less than the shares are actually worth. Hidden reserves have the further disadvantage of making it appear that they were created to evade taxes or to deceive stockholders. Tax complications may arise from charges of evasion.

Necessity for restoring past impairment of capital before declara-

tion of dividend. If, through loss, or mismanagement or misconduct on the part of directors or officers, or for any other reason, the assets of the corporation are reduced below the sum of the capital stock plus liabilities, the balance sheet of the corporation will show a deficit, and its capital will be impaired. The corporation may not declare dividends under such circumstances, even though sufficient earnings are shown for the current year to enable it to pay dividends on its outstanding stock, if the amount of such earnings is not sufficient to restore the impairment of capital then existing and to pay dividends.⁵³ This is the rule according to most American decisions. But some states, either by statute or judicial decision, permit payment of dividends out of profit, even though capital is impaired.⁵⁴ However, no dividends may be paid if the value of the net assets is less than the stated capital represented by all shares having a liquidation preference.

(In England a corporation may declare dividends in any year in which there are net earnings sufficient to warrant the payment of such dividend, without the necessity of restoring past impairment of capital.⁵⁵)

Impairment of capital in corporations with wasting assets. The rule that payment of dividends must not impair the capital of the corporation is modified when applied to corporations with wasting assets.⁵⁶ A wasting asset corporation is one engaged in exploiting such assets as coal, iron mines, timber lands, or oil or gas wells, or a corporation that holds property having a limited life, such as a lease for a term of years, or patents or copyrights. Such corporations, in the

⁵³ *Lich v. United States Rubber Co.*, supra (Note 22); *Commissioner v. W. S. Farish & Co.*, (1939) 104 F.(2d) 833.

⁵⁴ *United States v. Riely*, (1948) 169 F.(2d) 542, cert. den., (1949) 335 U.S. 908, 69 S. Ct. 411. The old Virginia statute provided for the payment of dividends "out of net earning, or out of its net assets in excess of its capital," and the Federal Court interpreted it as permitting a Virginia corporation to pay dividends out of earnings despite a deficit. See also, e.g., Cal. G.C.L. §1500, Del. G.C.L. §170. For statutory provisions in all states see *Prentice-Hall Corporation*.

⁵⁵ See C. F. Schlatter, "Payment of Dividends before Restoring Impaired Capital," *J. ACCOUNTANCY*, March, 1923, for citations of English cases and for analysis of American decisions which are frequently cited by writers to show that dividends may be paid while capital is impaired.

⁵⁶ See *Bailey v. Guaranty Liquidating Corp.*, (1936) 16 Cal. App. (2d) 401, 60 P.(2d) 579.

absence of a contract to the contrary, may declare dividends without making provision for past impairments of capital and without first providing for a depletion reserve for the recoupment of its wasting assets.⁵⁷ They may regard as profits for dividend purposes, all receipts, less the cost of production, the cost of marketing, and overhead expenses, without any charge or reserve for depletion of capital.⁵⁸ (In some states, when the dividend is declared, the stockholder must be notified that no deduction or allowance has been made for such depletion.) However, the corporation, on the basis of this doctrine, may not sell its capital assets—one of its mines, for example—and distribute the profits in the form of dividends.⁵⁹

Wasting asset corporations having two classes of stock, common stock and a class of preferred stock that is preferred as to assets upon liquidation or dissolution of the corporation, may not, on the basis of the wasting asset doctrine, pay dividends on the class which is not preferred as to assets, if the capital is impaired to such an extent that there is not available for the preferred stockholders sufficient capital to pay them the par value of their shares in the event of dissolution or liquidation.⁶⁰ Before paying dividends on the common stock, provision must be made, by means of a reserve, for paying off preferred stockholders. To do otherwise would be equivalent to placing the capital values of the corporation's assets into the pockets of the common stockholders by way of dividends, to the exclusion of preferred stockholders whose contracts give them, in relation to the common stockholders, a first and prior right to the assets.

Methods of eliminating a deficit. As indicated above, a corporation may not ordinarily declare a dividend if, at the time of the proposed distribution, the corporation's balance sheet reveals a deficit. This deficit may be wiped out, however, in the following ways:

1. Revaluing assets that have been carried on the books at an under-evaluation. Any one of the following bases are available for the revaluation: (a) original cost less depreciation; (b) replacement

⁵⁷ *De Brabant v. Commercial Trust Co.*, (1933) 113 N.J. Eq. 215, 166 A. 533.

⁵⁸ *Excelsior Water & Mining Co. v. Pierce*, (1891) 90 Cal. 131, 27 P. 44.

⁵⁹ *Ibid.*

⁶⁰ *Wittenberg v. Federal Mining & Smelting Co.*, (1926) 15 Del. Ch. 147, 133 A. 48. In this case previous decisions on the wasting assets doctrine are reviewed.

cost; (c) value that may be realized at a forced sale; or (d) present market⁶¹ or present sales value.⁶²

2. Converting unnecessary reserves into surplus. When a corporation has accumulated reserves beyond its requirements, the directors may, in accordance with accepted accounting procedure, use the unnecessary reserves to wipe out a deficit. The directors then have the power to convert any excess of reserves over deficit into a surplus to be distributed as dividends.

3. Reducing capital stock.⁶³ For example, if the par value of a corporation's stock outstanding is \$500,000, and its assets are \$600,000 and its liabilities \$200,000, the deficit of \$100,000 can be wiped out and a surplus created by a reduction of the capital stock to \$250,000 effected through a decrease in the par value per share or in the number of shares outstanding. In the case of no-par stock, the stated capital can be reduced by a reduction in the number or stated value of the issued shares, or by changing no-par shares to par shares with a par less than the former stated value. The action must, of course, be sanctioned by charter amendment.

4. Capitalizing the initial deficit as goodwill and placing the account on the books, the company eliminates the deficit and creates a surplus. (See p. 1132.)

In order that the action of the board of directors in eliminating the deficit may be legally effective, it must be taken under the following conditions:

1. The board of directors must act honestly and in good faith; their action must be free from fraud.

2. The elimination of the deficit must not be effected in a way that is contrary to the provisions of the statute under which the corporation is organized or to the interpretation given the statutes by court decision.

⁶¹ See *Randall v. Bailey*, *supra* (Note 28). The court held that directors may consider unrealized appreciation in the value of fixed assets held for use in carrying on a corporate enterprise in determining whether a surplus exists from which a cash dividend may be paid.

⁶² *Morris v. Standard Gas & Elec. Co.*, *supra* (Note 50).

⁶³ *Graham v. Louisville Transit Co.*, *supra* (Note 35). Also see "Surplus after reduction of capital stock" at page 1124.

3. The action must be justified by the facts.

Writing up goodwill to eliminate a deficit. During the early life of a corporation losses may be incurred in establishing the business and putting it on a paying basis. After the corporation has reached a point where its reputation is established and where operation at a profit is assured, the directors may feel that the company has created goodwill equivalent to or greater than the deficit. They might argue that the net operating loss in excess of income during the initial period was in reality development expenses incurred in establishing a steady patronage and the good name of the concern. By capitalizing the initial deficit as goodwill and placing the account on the books, the company eliminates the deficit and creates a surplus.

Accountants almost without exception agree that goodwill should not be recognized in the accounts unless it has been purchased,⁶⁴ regardless of whether it is to capitalize the initial deficit at the outset of corporate existence or if it is after years of profitable operation. As to capitalizing initial deficit as goodwill, they maintain that goodwill created under such circumstances is merely a device for effecting an eventual inflation of the earned surplus account by relieving it of charges for expenses and losses.

Financial policy in determining what part of the surplus shall be used for dividends. Once having determined that from a legal standpoint, surplus or profits are available for the payment of dividends, the directors must decide whether it is advisable, as a matter of financial policy, to use part or all of that legal surplus or profits for dividends.

Surplus, from a financial standpoint, is the amount shown on the corporate balance sheet as the difference between the value of the assets and the sum of the capital stock, liabilities, and reserves. It is immaterial whether the surplus assets are carried on the books of the company as surplus, segregated assets, or in a special fund

⁶⁴ The following cases discuss the question of valuation of goodwill: *Rockwood Pottery Co. v. Commissioner*, (1930) 45 F.(2d) 43; *Securities Realization Co. v. Peabody & Co.*, (1939) 300 Ill. App. 156, 20 N.E.(2d) 874; *Colton v. Duvall*, (1931) 254 Mich. 346, 237 N.W. 48; *Randall v. Bailey*, *supra* (Note 28).

account.⁶⁵ The directors know whether the value of the assets shown on the books of the corporation and in its balance sheet represents the actual value of the items listed. They know whether the property of the corporation has depreciated and whether proper allowance has been made. With a definite dividend policy in mind, and with an intimate knowledge of the affairs of the corporation, they can determine the extent to which reserves should be set up.

If the directors have decided on a definite dividend policy, they can determine what part of the surplus of the corporation should be "plowed back" into the property of the corporation, and what part they are willing to have the stockholders know is available for dividends. The part of the surplus that the corporation intends to keep in the business is generally termed "surplus" in the accounts of the corporation, and the part of the surplus that the corporation intends to use for dividend distributions is termed "undivided profits." By an analysis of the balance sheet, the directors can determine whether the corporation has accumulated reserves beyond its requirements, and if so, whether the unnecessary reserves can be converted into a surplus to be distributed as dividends.

Sources of surplus available for dividends, from financial standpoint. The availability for dividends, from a financial viewpoint, of some of the more common sources of surplus is discussed below.

Earnings from regular operations. A surplus built up from this source would ordinarily be available for dividends.

Earnings accumulated from previous years. The purpose of accumulating surplus is to enable the corporation to pay dividends in lean years. There is no reason, therefore, why the directors should not feel free to use the accumulated surplus for dividends.

Income from subsidiaries. Amounts received from subsidiaries may be distributed as dividends to stockholders of the parent company without jeopardizing the interests of the corporation.

Sales of appreciated property. If the property sold is to be replaced by similar property, the profits should not be distributed in the

⁶⁵ Hyams v. Old Dominion Mining & Smelting Co., (1913) 82 N.J. Eq. 507, 89 A. 37, citing Bassett v. United States Cast Iron Pipe & Foundry Co., (1908) 74 N.J. Eq. 668, 70 A. 929, *aff'd on appeal*, (1909) 75 N.J. Eq. 939, 73 A. 514.

form of dividends; if the property sold was unnecessary, the profits may be distributed.

Revaluation of assets. A profit shown on the books by a revaluation of the assets should not be made the basis of a dividend, since it is possible that the value will fall. On the other hand, if intangible assets such as investment securities depreciate in value on the market, there seems to be no authority for requiring the corporation to write down the value of its assets before determining the amount of its surplus.

Sale of securities at a premium. Dividends should not be paid from this source, even where permitted by law, unless the stockholders and bondholders knew before they paid for their securities that a part of their money would be used for dividends.

Amounts credited to paid-in surplus upon the sale of no-par stock. A surplus from this source would be treated exactly like a surplus from the sale of securities at a premium.

Conversion of unnecessary reserves. Surplus created from this source may be distributed in the form of dividends, but it would be advisable for the directors to inform the stockholders of the change in the reserves and to leave the amount in the surplus for some time before using it for dividends, in order not to subject themselves to the suspicion of manipulation.

Secret reserves. The statements made in regard to the conversion of unnecessary reserves would apply to secret reserves.

Donated surplus. Surplus from this source should not be used for dividends without a full explanation that the dividend is being declared from this source.

Surplus from constituents of a consolidation. The sources of surplus received from constituents should be analyzed and the rules given above applied.

Setting up accounts to show surplus available for dividends. The reason for setting up a surplus account is to show the increase in the assets of the corporation over capital stock plus liabilities. Since such increases may arise from revaluations of physical property, market appreciation of securities held as investments, fictitious assets such as bond discount, organization expenses, and the like, profits received

in the regular course of business, premiums upon the sale of stock, donations, and from other sources, the surplus account as such is of little value to the directors in determining the amount available for dividends, and to the stockholders in determining the value of their stock.

Assuming that reserve accounts have been set up, the surplus account represents two things: (1) profits arising from the operation of the business, which is properly termed "earned surplus profits"; and (2) surplus that arises in other ways, which may be properly termed "paid-in" surplus. These "other ways" include: (1) premiums upon the sale of stock; (2) a part of the consideration received from the sale of no-par stock, set aside by the directors as "paid-in" surplus; (3) amounts received upon the sale of treasury stock; (4) donations made by stockholders or others to the corporation; (5) forfeited payments made upon stock subscribed; (6) increases in the value of assets beyond that originally entered when property was received for capital stock; (7) reductions in capital stock made through redemption at a figure lower than the amount originally received for the stock; and (8) additional assessments on par value stock. Rarely is paid-in surplus likely to result from this last source, since in those states where assessments are permitted, they are generally intended for the purpose of paying expenses, conducting the business, or paying debts.

The best accounting practice requires that the surplus account be divided into earned surplus and capital surplus or paid-in surplus. The directors can tell at a glance that the earned surplus account is available for dividends. They can by analysis of the capital surplus or paid-in surplus account, determine what part is available for dividends. Furthermore, the surplus account thus divided is especially valuable for purposes of comparing earnings from year to year. Dividends distributed would be charged to the earned surplus account; and any distributions traceable to sources that make up the capital surplus account would be charged to the capital surplus or paid-in surplus account.

If the corporation wishes its stockholders to obtain from the balance sheet an idea of what part of its earned surplus it intends

to use for dividend purposes, it may divide its earned surplus account into undivided profits and earned surplus. Three surplus accounts will then appear on the balance sheet: undivided profits, which the directors and stockholders will know is intended for dividends; earned surplus, which is available for dividends; and capital surplus or paid-in surplus, which is made up of sources not immediately available for dividends.

Arguments in favor of a large surplus. The directors should bear in mind that certain advantages accrue from a large surplus built up by a conservative dividend policy. These advantages are well expressed in the following excerpt from the annual report of a large public utility corporation:

Among the more important advantages to a company of a large surplus represented in the fixed assets are the following:

1. It strengthens the company's credit, enabling the company to make its interest and dividend payments uniform and dependable.
2. It enables the company on the strength of this credit to obtain its capital requirements on the most favorable terms.
3. It enables the company to ride out commercial and financial disturbances which might otherwise cripple or destroy it.
4. It enables the company to maintain at all times the highest state of efficiency in its operation, which would be impossible for any company which is obliged to adjust its more or less inflexible operating expenses to the constant and inevitable fluctuations of business.
5. It is a reservoir, as it were, which, supplied by a fluctuating stream of gross revenue, enables the company to maintain even and uniform disbursement for service, maintain a uniform operating organization, and that high state of efficiency which can result only from a permanent operating force.

➤➤➤**WARNING**➔ Provisions of various tax laws, designed to prevent evasion of taxes by failure to declare a dividend, provide for a very high rate of punitive tax upon excessive surpluses maintained by the corporation. Although arguments in favor of a large surplus, as set forth in the foregoing section, are sound from the point of view of financial security, great care should be taken to avoid conflict with the provisions of tax laws, lest the tax penalty be so great as to destroy the economic advantages. In addition, there is the danger that if the directors fail to declare dividends and the corporation is compelled to pay a tax penalty, the directors may be held liable in a stockholders' derivative action for the damage caused the corporation. (See also p. 1161.)

Advantages of stable dividends. Certain definite advantages are

gained by maintaining a stable dividend policy. These are: (1) the credit of the company improves; (2) the value of the corporation stock increases; (3) the securities of the company may become eligible as legal investments, that is, investments for trustees and financial institutions such as savings banks and insurance companies; (4) if the stockholder receives dividends regularly from year to year, he will in the aggregate pay less income tax than if he receives a large extra dividend in one year and small dividends in other years; and (5) the stock, if publicly traded in, will be less subject to violent fluctuation based on recurrent dividend rumors.

CLASSIFICATION OF DIVIDENDS

Kinds of dividends. Dividends may be classified as "regular" and "extra." A dividend additional to that which the corporation has been paying, or which the corporation is required to pay, is an extra dividend. If an extra dividend is paid continuously, it may lose its identity as an extra dividend and become a regular dividend. The payment of extra dividends and the labeling of dividends as regular or extra are purely matters of financial policy to be determined by the directors.⁶⁶ Dividends may also be divided into "profit dividends" and "liquidation dividends."⁶⁷ Dividends paid by a going concern out of the profits of the business and not as a step toward liquidation or dissolution are profit dividends. In this chapter we are concerned only with profit dividends. Liquidation dividends are a distribution of the property among the stockholders, with a view to an entire or partial suspension of operations.⁶⁸

Dividends may also be classified according to the manner of payment, as will be indicated in the following paragraphs.

Medium in which dividends may be paid. The board of directors may declare dividends payable in cash, property, scrip, bonds, stock, or in cash or stock at the option of the stockholder. The determina-

⁶⁶ *St. Louis Southwestern Ry. v. Meyer*, (1954) 364 Mo. 1057, 272 S.W.(2d) 249.

⁶⁷ *Byerly v. Camey*, (1942) (Tex. Civ. App.) 161 S.W.(2d) 1105.

⁶⁸ The rule that capital may not be impaired by payment of dividends out of capital assets does not apply to distribution in liquidation or dissolution. See *Wouk v. Merin*, (1953) 283 App. Div. 522, 128 N.Y.S.(2d) 727; *Hay v. Hay*, (1951) 138 Wash. Dec. 485, 230 P.(2d) 791.

tion of the medium to be used lies within the discretion of the directors. The amount of cash the corporation has on hand and in the banks is no indication of the corporation's ability to declare and pay a dividend, although it may have a decided influence on the medium in which a dividend is paid.

Cash dividends—borrowing to pay dividends. If a corporation has a surplus and no ready funds to pay a cash dividend, it may borrow a sum not exceeding the amount of the corporate surplus for the purpose of paying a dividend.⁶⁹ The fact that borrowed money is to be used for the payment of dividends does not render the declaration and payment illegal, where it appears that the corporation had used surplus profits equal to the amount of the dividend paid, for the purpose of improving the corporate property.⁷⁰ If the profits have been invested in corporate property and therefore money must be borrowed to pay dividends, it may be considered that money was borrowed for the purpose of carrying on the corporate business, and the payment of the dividend with the borrowed money is not illegal.⁷¹

In deciding upon a cash dividend, these questions must be answered: (1) Does the cash position of the company justify a cash distribution at the present time? (2) What is the general economic condition of the country and the trade prospects in the particular industry? For example, if the corporation is expanding rapidly and a high price would have to be paid if the corporation were to borrow money for expansion purposes, it would be inadvisable to distribute its cash in the form of a dividend.

Dividends payable in property. The surplus of a corporation is not represented by any particular asset, but is a mathematical proposition, namely the *excess* of assets over liabilities and capital. Therefore any asset, or any part of any asset, capable of being apportioned, may be paid out as dividends. Thus, if a corporation which has a surplus holds stock in another corporation, or real property not necessary for corporate purposes, that stock or real property is legally

⁶⁹ *Alabama Consolidated Coal & Iron Co. v. Baltimore Trust Co.*, (1912) 197 F. 347; *Oshrin v. Celanese Corp.*, (1942) 37 N.Y.S.(2d) 593; *Cox. v. Leahy*, *supra* (Note 23); *West v. Hotel Pennsylvania*, (1942) 148 Pa. Super. 373, 25 A.(2d) 593.

⁷⁰ *Excelsior Water & Mining Co. v. Pierce*, *supra* (Note 58).

⁷¹ *Gilbert Paper Co. v. Prankard*, (1923) 204 App. Div. 83, 198 N.Y. Supp. 25.

distributable to the extent of the surplus just as if it were cash.⁷² Such a dividend is properly called a property dividend.

A company does not warrant the title to property which it distributes as a property dividend,⁷³ and may not compel a stockholder to take the property distributable to him as a dividend.⁷⁴ For example, if the corporation were distributing stock of another corporation to its shareholders, the latter might not wish to have imposed upon them the liability as stockholders of the corporation whose stock is being distributed. If a stockholder should refuse to take the property dividend, the corporation may retain it in trust for him, sell it for his benefit, or handle it in some other way sanctioned by law.⁷⁵ The stockholder does not have the option to receive an equivalent amount of cash in lieu of a property dividend.⁷⁶

Scrip dividends. A "scrip dividend" is a distribution of surplus to the stockholders in the form of notes or promises to pay the amount of the dividend at a certain time. This form of dividend may be legally paid.⁷⁷ The notes are called "dividend certificates" or "scrip," and usually bear interest at a fixed rate from the date of the note.

In order for the notes to be valid, the corporation must have actual earnings out of which to pay the dividend⁷⁸ and the notes must be issued pursuant to a resolution passed at a validly constituted meeting of the directors.⁷⁹

A scrip dividend is advisable generally under the following circumstances: (1) when the corporation has a surplus but not sufficient cash with which to pay a dividend, and the directors do not wish to borrow for the purpose of obtaining cash but do desire to have present stockholders participate in the earnings of the cor-

⁷² *Liebman v. Auto Strop Co.*, (1926) 241 N.Y. 427, 150 N.E. 505.

⁷³ *Olsen v. Homestead Land and Improvement Co.*, (1894) 87 Tex. 368, 28 S.W. 944.

⁷⁴ *State v. B. & O. R.R.*, (1847) 6 Gill (Md.) 363. See also *Strout v. Cross*, *Austin & Ireland Lumber Co.*, (1940) 283 N.Y. 890, 28 N.E.(2d) 890, citing *Williams v. Western Union Tel. Co.*, (1883) 93 N.Y. 162.

⁷⁵ *Williams v. Western Union Tel. Co.*, *supra* (Note 74).

⁷⁶ *State v. B. & O. R.R.*, *supra* (Note 74).

⁷⁷ *Bankers' Trust Co. v. R. E. Dietz Co.*, (1913) 157 App. Div. 594, 142 N.Y. Supp. 847. See also *Hupp Motor Car Corp. v. Guaranty Trust Co.*, (1939) 171 N.Y. Misc. 21, 11 N.Y.S.(2d) 855, in which it was held that an offer of means whereby holders of scrip may convert their scrip into cash may be revoked by the corporation at any time.

⁷⁸ *Stagal Oil Co. v. Bartholomew*, (1940) (Tex. Civ. App.) 144 S.W.(2d) 1012.

⁷⁹ *Meyers v. El Tejon Oil & Refining Co.*, (1946) (Cal. App.) 169 P.(2d) 60.

poration; (2) when the corporation has a surplus and cash but wishes to reserve the cash for corporate purposes; (3) when the corporation wishes to distribute the profits earned upon the stock, in order to avoid any future dispute as to the right thereto between present shareholders and their successors in interest, such as life tenants and remaindermen.

Bond dividends. The payment of a dividend in the form of bonds is unusual, but in the absence of statutory provisions to the contrary, a corporation has the right to distribute its surplus in the form of bonds, and may even secure the bonds by a mortgage upon its property.⁸⁰ The objection to issuing bonds as a dividend is that the corporation thus binds itself to pay interest on the amount of bonds so distributed, whether or not sufficient earnings are made to pay the interest, and furthermore, to pay the principal of the bond at maturity, whether or not the financial position of the corporation warrants payment of such principal.

Stock dividends.⁸¹ In the absence of a provision in the constitution, statute, charter, or by-law to the contrary, the surplus of a corporation may be distributed through the issuance of shares of stock equivalent to the amount of the surplus, to the shareholders entitled to the dividend, pro rata according to their stock holdings.⁸² A stock dividend need not be paid in shares of the same class of stock as that on which the dividend is paid.⁸³ The payment of a stock dividend is in the discretion of the directors,⁸⁴ and the consent of the stockholders is not necessary. However, if the corporation must increase its capital stock in order to have shares available for distribution of the stock dividend, the consent of the stockholders is necessary. If the statute or charter requires that the dividend shall be paid in cash, the corporation cannot declare a stock dividend

⁸⁰ *Wood v. Lary*, (1888) 47 Hun. (N.Y.) 550.

⁸¹ For a discussion of stock dividends, their advantages and disadvantages, the mechanics of declaring and paying stock dividends, the related tax problems, etc., see *Prentice-Hall Corporation*.

⁸² Surplus must exist before a corporation may declare a stock dividend. *Gearhart v. Lee-Clay Products Co.*, (1941) 287 Ky. 316, 152 S.W.(2d) 1003.

Distribution of additional stock without capitalization of surplus is not a stock dividend but a "split-up." *In re Muller's Estate*, (1956) 158 N.Y.S.(2d) 417.

⁸³ *Commissioner of Corporations and Taxation v. Morgan*, (1940) 306 Mass. 305, 28 N.E. 338.

⁸⁴ *Williams v. Western Union Tel. Co.*, *supra* (Note 74).

and compel the stockholders to accept stock instead of cash.⁸⁵ Also, it has been held that a court of equity may interfere to compel the payment of a cash dividend if the purpose of the stock dividend is to keep the profits of the business within the control of those dominating the affairs of the corporation.⁸⁶

The corporation may not distribute a stock dividend to a particular class of stockholders if the effect of such action would be to deprive stockholders of another class of their rights. For example, suppose Corporation *A* has \$100,000 of 5 per cent preferred stock and \$100,000 of common stock, the only difference between the two classes being that the preferred stock has a preference as to dividends. The corporation proposes to capitalize its surplus of \$50,000 and to declare a stock dividend on the common stock alone. It is not permitted to do so, for the issuance of a stock dividend to the common stockholders to the exclusion of the preferred stockholders would constitute an impairment of the rights of the preferred stockholders. They would be entitled to equitable relief if the stock had not yet been delivered, or to damages for breach of contract if the stock had been already delivered.⁸⁷

The usual statutory provision requiring that stock be paid for in cash, property, or services is not violated by the issuance of a stock dividend. The declaration of a stock dividend upon par value stock involves the capitalization of surplus to the extent of the total par value of the shares distributed, and the capital thus created constitutes payment for the additional shares issued as a result of the stock dividend.⁸⁸

⁸⁵ *Hardin County v. Louisville & Nashville R.R.*, (1891) 92 Ky. 412, 17 S.W. 860.

⁸⁶ *Keough v. St. Paul Milk Co.*, (1939) 205 Minn. 96, 285 N.W. 809.

⁸⁷ *Riverside & Dan River Cotton Mills v. Thomas Branch & Co.*, (1927) 147 Va. 509, 137 S.E. 620. See *Niles v. Ludlow Valve Mfg. Co.*, (1913) 202 Fed. 141, in which it was held that where the certificate of incorporation provides that the preferred stock should "receive interest or dividends of 8% per annum and be preferred as to capital as well as to dividends," a stock dividend to the common stockholders alone was valid. See also *Tennant v. Epstein*, (1934) 356 Ill. 26, 189 N.E. 864.

⁸⁸ *Young v. Bradford County Tel. Co.*, (1941) 341 Pa. 394, 19 A.(2d) 134. In *Tennessee*, however, the court held that an application to amend the charter not only to enable the corporation to increase its corporate stock but to grant it the right to pay for the increased stock in surplus and undivided profits, consisting of both tangible and intangible assets, was illegal and void, because the legislature had not granted it either the right or the power to pay for its stock in this way. *United Hosiery Mills Corp. v. Stevens*, (1921) 146 Tenn. 531, 243 S.W. 656. In this case the procedure followed in amending the charter was also questioned.

Before a corporation declares a stock dividend, directors should be reasonably certain that the prospects for future earnings are sufficiently favorable to warrant the expectation that the corporation will earn a fair rate of dividends on the increased amount of stock that will be outstanding after the dividend has been distributed.

Examples of uses of stock dividends. The declaration of a stock dividend may be advisable as a step in the readjustment of the capitalization. For example, the corporation may be earning at the rate of 40 per cent on its outstanding stock. In order to reduce the apparent rate of earnings, it may split its stock or declare a stock dividend. Unless the corporation has been accumulating its surplus for a number of years, it will have to write into the asset side of its accounts some item such as goodwill, in order to build up a sufficiently large surplus to justify the declaration of the 100 per cent or 200 per cent stock dividend that will be needed.

A stock dividend may be necessary to protect the interests of old stockholders when a company is about to sell a new issue of stock. For example, if, at the time a corporation is in need of additional capital, the book value of each share of stock having a par value of \$100 is considerably more than par, the corporation must sell the new stock at more than par in order to protect the interests of the existing stockholders, unless the stockholders take all of the new stock in the proportion in which they own the outstanding stock. The corporation knows that it will be extremely difficult to get new investors to pay more than par for the stock. To overcome this difficulty, the corporation will declare a stock dividend before the new stock is offered to outsiders, and it will thus preserve the sole ownership of the surplus for the old stockholders.

Effect of a stock dividend, in general. The effect of a stock dividend is: (1) the transfer to the capital account of surplus and undivided profits to the extent of the stock dividend; (2) an increase in the number of ownership units into which the property of the corporation is divided; (3) no change whatever in the property of the corporation.⁸⁹ It has even been held that a statutory prohibition

⁸⁹ *Powell v. Maryland Trust Co.*, (1942) 125 F.(2d) 260, citing *Gibbons v. Mahon*, (1890) 136 U.S. 549, 10 S. Ct. 1057; *First Nat'l Bank v. Hill*, (1941) 241 Ala. 606, 4

against the declaration of dividends in "cash or property" out of unrealized assets does not apply to a stock dividend, because it does not decrease the company's capital assets.⁹⁰

So far as the stockholder is concerned, a stock dividend does not result in income to him. Thus it has been held that a stock dividend is not "dividends or other income" within the terms of an agreement of pledge providing that "all dividends or other income" shall continue to be paid to the pledgor.⁹¹ The Supreme Court of the United States has held that a stock dividend is not income to the recipient for federal income tax purposes,⁹² and the rule thus laid down is now contained in the Internal Revenue Code itself. A stock dividend becomes the property of the stockholder from the date of its declaration, and not from the date of its payment.⁹³

Transfers from surplus to capital upon payment of stock dividends. An ordinary stock dividend implies a transfer of earned surplus to capital account, whether the latter is designated as capital stock or capital surplus. The directors should determine: first, the total amount to be transferred from earned surplus to the capital account; second, the number of shares to be issued in connection with the transfer. Upon payment of a stock dividend, the corporation should transfer the earned surplus in an amount equal to the fair value of the additional shares issued.⁹⁴ Generally, the statutes, charter, or by-laws set minimum legal requirements with respect to the per share amount to be capitalized. Ordinarily, the required amount is a sum sufficient to make the shares "fully paid." This sum is the par value on the par value stock and is the stated value

So.(2d) 170; *Burns v. Hines*, (1939) 298 Ill. App. 563, 19 N.E.(2d) 383; *Commissioner of Corporations and Taxation v. Morgan*, supra (Note 83); *City Bank Farmers Trust Co. v. Ernst*, (1934) 263 N.Y. 342, 189 N.E. 241.

⁹⁰ *Berks Broadcasting Co. v. Craumer*, supra (Note 29).

In the absence of a prohibitive provision, corporate charters may permit a stock dividend to be paid out on the basis of the unrealized appreciation of the capital paid in at the time when the corporation was chartered.

⁹¹ *Baumann v. Stetten*, (1931) 257 N.Y. 480, 178 N.E. 764.

⁹² *Eisner v. Macomber*, (1920) 252 U.S. 189, 40 S. Ct. 189. See also *Prentice-Hall Federal Taxes*.

⁹³ *Matter of Booth*, (1931) 139 N.Y. Misc. 253, 248 N.Y. Supp. 264.

⁹⁴ *Accounting Research Bulletin*, No. 43 (1953).

It has also been held that capitalization of earned surplus is unnecessary if the number of additional shares issued as a stock dividend is so large that it may reasonably be expected to reduce the shares' market value, or if the stock dividend is actually a stock-split. (See Note 82.)

on no-par stock with stated value. In no-par stock without stated value, the amount to be capitalized is left to the discretion of the directors.

While the legal requirements set forth the minimum capitalization figure, the directors may actually capitalize a larger amount than is required. If, therefore, the per share amount capitalized exceeds the par or stated value, only the par or stated value should be credited to the capital stock account; the excess should be credited to the capital surplus account. In the case of no-par stock without stated value, it may even be desirable to credit at least part of the amount capitalized to the capital surplus account instead of crediting the whole amount to the capital stock account.

Example: A corporation has capital of \$450,000 (\$375,000 capital stock and \$75,000 capital surplus), with 7,500 shares of no-par value common stock outstanding. It has an earned surplus of \$400,000. The directors decide to capitalize \$300,000 of the earned surplus. The total capital value per share is \$60 ($\$450,000 \div 7,500$). The directors would be able to distribute 5,000 shares as a stock dividend ($\$300,000 \div 60$). However, the average market price of the stock over the period during which the income to be capitalized by the stock dividend was earned was, let us say, \$80. To maintain a reasonable relationship to this fair market value, the corporation declares a stock dividend of 3,750 shares ($\$300,000 \div 80$). After distribution of the stock dividend, the corporation has a capital of \$750,000, with 11,250 shares of no-par value common stock outstanding; the capital value on the books is \$66.66 plus per share.

Notice to the stockholders of a stock dividend. When a corporation issues a stock dividend it should tell the stockholder:

1. The amount of earned surplus capitalized per share.
2. The aggregate amount of earned surplus capitalized.
3. The capital account or accounts to which the aggregate amount has been charged and credited.
4. The percentage by which the stockholder's interest in the corporation before issuance of the stock dividend will be reduced if he should sell his dividend shares.

Stock split-ups. Corporations may distribute additional shares of stock and leave the surplus account intact. Such a distribution is a split-up of the stock, and not a stock dividend. The term "stock dividend" is properly used only when there is a capitalization of earned surplus.

The effect of a stock distribution without a reduction of the surplus account, is to reduce the pro rata interest of each no-par shareholder in the corporation. These further results are obtained: (1) the market price of each share of stock is reduced; (2) the corporation may increase its distribution of dividends without increasing the rate of dividends or declaring "extras"; (3) by reducing the market price of its stock, wider distribution is obtained; (4) the corporation avoids the antagonism that prosperous corporations with high-priced stocks provoke; (5) having split the stock without affecting the surplus account, the corporation may distribute its surplus in the form of a cash dividend on the increased number of shares outstanding.

The same result may be obtained by corporations having par value stock by changing such stock to no-par value stock and giving in exchange for each share of par value stock a certain number of shares of no-par value. An alternative is to reduce the par value of each share of stock and give the holder of an original share an increased number of shares with lower par value per share, the ratio of the exchange depending upon the rate of decrease. Frequently a corporation will split its shares and, in addition, declare a stock dividend. In the split-up, no transfer is made from the surplus account to the capital account, but in the distribution of the stock dividend, the surplus is reduced by the amount of the stock dividend.

Dividends payable in cash or in stock. A dividend payable in cash or in stock may be declared. The stockholder is given a certain number of days within which to notify the corporation that he chooses to apply his dividend to the purchase of additional stock. In some cases, provision is made for all dividends to be paid in cash unless notice to the contrary is received; in others, all dividends are applied to the purchase of shares unless notice is received by the

corporation that the stockholder elects to receive his dividend in cash.

This type of optional dividend differs from a stock dividend⁹⁵ in the following respect: In the case of a stock dividend, the stockholder may refuse to accept the shares of stock offered as a dividend, but he cannot demand cash in lieu of such shares; in the case of the dividend payable in cash or in stock, the stockholder may take cash or he may apply his dividend to the purchase of additional shares of stock.⁹⁶

RIGHTS AND LIABILITIES RELATING TO DIVIDENDS

Right to dividends as between stockholders of the same class. All the stockholders of a class of stock upon which a dividend has been declared must be given their pro rata share of the dividend according to their stockholdings, without discrimination, and regardless of the time when the stock was acquired.⁹⁷ Such discrimination as declaring the dividend payable only to certain stockholders of the class and not to others,⁹⁸ offering some of the shareholders payment in one medium and other stockholders payment in some other form,⁹⁹ or giving certain stockholders of the class larger dividends than others, is not permissible.¹⁰⁰ However if all the stockholders entitled to participate in a dividend authorize, ratify, or acquiesce in a distribution of the surplus among themselves on other than a pro rata and equal basis, the dividend may be distributed on the basis agreed upon.¹⁰¹ Corporate stock held in the treasury is not entitled to a dividend.¹⁰²

⁹⁵ A dividend payable in cash or stock is not a stock dividend. *Kellogg v. Kellogg*, (1938) 166 N.Y. Misc. 791, 4 N.Y.S.(2d) 219, aff'd, memo dec., 254 N.Y. App. Div. 812, 5 N.Y.S.(2d) 506, 507, 509.

⁹⁶ Where the directors declared a dividend payable in stock or cash, and the stockholders accepted notes in payment of the dividend to avoid federal tax on corporation's surplus, it was held that one of the stockholders could not thereafter demand stock instead of cash. *Coon v. Schlimme Dairy Co.*, (1940) 294 Mich. 51, 292 N.W. 560.

⁹⁷ *Jones v. Terre Haute, etc. R.R.*, (1874) 57 N.Y. 196.

⁹⁸ *Stout v. Oates*, (1950) 217 Ark. 938, 234 S.W.(2d) 506.

⁹⁹ *State v. B. & O. R.R.*, *supra* (Note 74).

¹⁰⁰ *Hale v. Republican River Bridge Co.*, (1871) 8 Kan. 312.

¹⁰¹ *Cleveland Shopping News Co. v. Routzahn*, (1937) 89 F.(2d) 902, aff'g 13 F. Supp. 362; *Brown v. Luce Mfg. Co.*, (1936) 231 Mo. App. 259, 96 S.W.(2d) 1098; *Breslin v. Fries-Breslin Co.*, (1904) 70 N.J.L. 274, 58 A. 313.

¹⁰² *H. J. Heinz Co. v. Driscoll*, (1941) 37 F. Supp. 803.

Right to dividends as between different classes of stockholders.

All shares of stock of a corporation stand on equal footing and participate equally in the organization and control of the company. They also participate equally in the distribution of corporate funds regardless of whether these funds are earnings or assets. Of course, there may be a classification of stock, which gives to members of one class rights and privileges not enjoyed by other classes. (See classifications of stock, p. 796.) In order for shares of stock of one class to have preference over shares of stock of another class, it is necessary that such preferences be stated either in the statute under which the corporation is organized, the certificate of incorporation, the by-laws, or some other form of contract binding on the corporation and the holders of such stock. The preferences, or rights, of one class of stock over another are therefore determined by the language of the preferential provisions contained in the statute, the certificate of incorporation, the by-laws, or other contract. Such documents constitute evidence of the contract between the different classes of stockholders, as well as between the corporation and its stockholders.¹⁰³

Right of preferred stock to stated dividends. The rule that dividends may generally be paid only when there are surplus profits or net earnings applies to preferred as well as to common stock.¹⁰⁴ (See p. 1117.) An express agreement to pay preferential dividends, whether or not there are profits sufficient for the purpose, would be beyond the power of the corporation, for a dividend paid when the corporation has no earnings is a return of capital.¹⁰⁵ The preferred dividend is not a debt that is guaranteed, but the right to a dividend from the earnings and income of the corporation. No obligation or right to declare the dividend arises until there is a fund from which it can properly be paid.¹⁰⁶ It has been held, however, that

¹⁰³ *Lyman v. Southern Ry.*, (1928) 140 Va. 274, 141 S.E. 240. See also *Wagstaff v. Holly Sugar Corp.* (1938) 253 App. Div. 616, 3 N.Y.S.(2d) 552, *aff'd*, memo dec., 279 N.Y. 55, 17 N.E.(2d) 681.

¹⁰⁴ *New York, L. E. & W. R.R. v. Nickals*, (1886) 119 U.S. 296; *Hazel Atlas Glass Co. v. Van Dyk & Reeves, Inc.*, (1925) 8 F.(2d) 716, cert. denied 269 U.S. 570, 46 S. Ct. 26; *Funderburke v. Magnolia Sugar Co-op., Inc.*, (1942) (La. App.) 8 So.(2d) 374.

¹⁰⁵ *Lockhart v. Van Alstyne*, (1875) 31 Mich. 76; *Castorland Milk & Cheese Co. v. Shantz*, (1919) 179 N.Y. Supp. 131; *Painesville, etc. R.R. v. King*, (1866) 17 Ohio St. 535; *Guaranty Mortgage Co. v. Flint* (1925) 66 Utah 128, 240 P. 175.

¹⁰⁶ *Chaffee v. Rutland R.R.*, (1822) 55 Vt. 110. See also *Lich v. United States Rubber*

preferred dividends may be paid out of current earnings even though such payment may impair the common stock capital structure.¹⁰⁷

The rule that the declaration of a dividend rests in the discretion of the board of directors applies to preferred as well as to common stock.¹⁰⁸ The fact that the corporation has guaranteed dividends on preferred stock under a statute permitting the guaranty of cumulative dividends payable out of net profits, does not make it incumbent upon the directors to declare a dividend out of net profits when, in their judgment, the corporation's business and financial condition do not warrant payment of a dividend. Thus, even if the profits sufficient to pay a preferential dividend have been earned, the directors may decide not to declare a dividend, if, in their honest judgment, such a declaration would not be for the best interests of the corporation.¹⁰⁹ Nor can the preferred stockholders compel the directors to pay a dividend in cash, when the directors have declared a stock dividend.¹¹⁰

A provision that the preferential dividends shall be dependent upon the profit of each particular year does not obligate the directors to declare dividends.¹¹¹ A provision in the articles of incorporation "that the preferred stock shall be entitled to dividends out of the net profits of the company as determined by the directors" does not mean that if there are net profits they must be distributed in any event, without regard to the condition of the company.¹¹² A provision in the certificate that, "Out of the surplus profits . . . , the holders of the preferred stock shall be entitled to receive dividends at the rate of 7% per annum, payable quarterly on the first

Co., *supra* (Note 22); *Hamblock v. Clipper Lawn Mower Co.*, (1909) 148 Ill. App. 618; *In re Fisher's Estate*, (1942) 344 Pa. 607, 26 A.(2d) 192.

¹⁰⁷ *Weinberg v. Baltimore Brick Co.*, (1955) (Del.) 114 A.(2d) 912, *aff'g* (1954) (Del. Ch.) 108 A.(2d) 81. The Chancery Court decision is commented upon in Note, "Amending Corporate Charter by Subsequent Permissive Legislation," 55 COLUM. L. REV. 415. Also see McDowell, "The Theory of Capital in Virginia: An Historical Comma and a Disjunctive Conjunction," 6 WASH. & LEE L. REV. 35; 62 HARV. L. REV. 130; 34 VA. L. REV. 860.

¹⁰⁸ *Guttman v. Illinois Cent. R.R.*, (1951) 189 F.(2d) 927, *cert. den.* 342 U.S. 867, 72 S. Ct. 107; *Morse v. Boston & Maine R.R.*, (1928) 263 Mass. 308, 160 N.E. 894; *Bassett v. U. S. Cast Iron Pipe and Foundry Co.*, (1909) 75 N.J. Eq. 539, 73 A. 514. See also *Wabash Ry. v. Barclay*, (1930) 280 U.S. 197, 50 S. Ct. 106.

¹⁰⁹ *New York, L. E. & W. R.R. v. Nickals*, *supra* (Note 104).

¹¹⁰ *Malone v. Armor Insulating Co.*, (1940) 191 Ga. 146, 12 S.E.(2d) 299.

¹¹¹ *New York, L. E. & W. R.R. v. Nickals*, *supra* (Note 104).

¹¹² *Fernland v. Frank Ridlon Co.*, (1923) 246 Mass. 64, 140 N.E. 421.

days of January, April, July, and October in each year . . . before any dividends shall be declared or set apart for the common stock," was held not to give preferred stockholders a contractual right to receive dividends whenever surplus profits existed.¹¹³

A certificate, however, may be drawn in such a way as to entitle preferred stockholders to the payment of dividends immediately out of the first profits made by the corporation.¹¹⁴ Below are some instances where a corporation was compelled to pay dividends in years in which there were net profits:

1. A provision in the certificate of preferred stock and in the certificate of incorporation that the holders of preferred stock are "entitled to dividends, not to exceed 6 per cent, payable semi-annually, not cumulative, whenever in any year the net earnings, after payment of all interest charges, suffice for the payment thereof," gives the preferred stockholders the right to dividends if the earnings of the corporation in each year exceed the expenses, and this right does not depend upon a declaration of the dividend by the board of directors.¹¹⁵

2. Where a by-law provided that preferred stock should carry a 7 per cent per annum cumulative dividend, payable quarterly, it was held that the directors must pay preferred dividends from available profits, although they consider it wiser to use the corporation's funds and credit for improvements.¹¹⁶

3. An agreement that directors should ascertain annual net earnings and "forthwith declare and pay" a dividend on designated stock was held to make a declaration of dividends mandatory in years when net earnings were available.¹¹⁷

Right of preferred stock to participate in surplus or earnings in excess of stated preference. The courts are not in accord as to the right of preferred stockholders to participate in the surplus or earnings of a corporation beyond the amount fixed by their con-

¹¹³ *Hassett v. S. F. Iszard Co.*, (1945) 61 N.Y.S.(2d) 451.

¹¹⁴ See *Hastings v. Internat'l Paper Co.*, (1919) 187 App. Div. 404, 175 N.Y.S. 815.

¹¹⁵ *Wood v. Lary*, *supra* (Note 80).

¹¹⁶ *New England Trust Co. v. Penobscot Chemical Fibre Co.*, (1946) (Me.) 50 A.(2d)

188. But see *Hassett v. S. F. Iszard Co.*, *supra* (Note 113).

¹¹⁷ *Crocker v. Waltham Watch Co.*, (1944) 315 Mass. 397, 53 N.E.(2d) 230.

tract.¹¹⁸ Some courts have held that, in the absence of provisions to the contrary, the preferred stock is "participating."¹¹⁹ This means that it is entitled to its fixed percentage of profits before the common stock shares in any distribution, and if there are profits left to be distributed, the common stock is entitled to the same percentage as the preferred has received, following which, if there are any further distributions to be made, the preferred and common stock share alike.¹²⁰ The reasoning on which this principle is based is that the preferred stockholders yield nothing in compensation for the benefits that they receive, but hold all the rights of the common shareholders, in addition to their preferential rights.¹²¹ Other courts have held that the preferred stock is "nonparticipating" in the absence of provision to the contrary; that is, after the prior rights of the preferred stockholders have been safeguarded, all the surplus earnings belong to the common stockholders.¹²² The basis for this principle is the fact that, in receiving the greater security for his preferential right, the preferred stockholder impliedly agrees to accept such rights in lieu of equal participation.¹²³

The statute, or the terms of the contract under which the preferred stock is issued, may specifically prescribe the stockholders' rights to dividends in excess of the stated preference.¹²⁴ Thus, if the contract provides that the preferred stockholders are to receive a dividend "up to, but not exceeding" the specified percentage, before any dividends are paid on the common stock, the holders of the common stock are entitled to all dividends above the fixed percentage.¹²⁵ Similarly, if the certificate of stock states that the preferred stockholders are entitled to noncumulative dividends at a specified rate and to "no other or further share of the profits," all

¹¹⁸ SEC 22 MINN. L. REV. 676; 12 ST. JOHN'S L. REV. 108.

¹¹⁹ See *United States v. Liberty Baking Corp.*, (1938) 25 F. Supp. 203. For a discussion of the various types of participating stock, see A. A. Berle, Jr., "Participating Preferred Stock," 26 COLUM. L. REV. 303.

¹²⁰ *Englander v. Osborne*, (1918) 261 Pa. 366, 104 A. 614.

¹²¹ *Stone v. United States Envelope Co.*, (1920) 119 Me. 394, 111 A. 536.

¹²² *Johnson v. Johnson & Briggs*, (1924) 138 Va. 487, 122 S.E. 100; see also *Whitney v. Puro Filter Corp.*, (1933) 63 F.(2d) 811; *James F. Powers Foundry Co. v. Miller*, (1934) 166 Md. 590, 171 A. 842; *In re Fisher's Estate*, supra (Note 106).

¹²³ *Stone v. United States Envelope Co.*, supra (Note 121).

¹²⁴ *Harr v. Pioneer Mechanical Corp.*, (1933) 65 F.(2d) 332.

¹²⁵ *Scott v. B. & O. R.R.* (1901) 93 Md. 475, 49 A. 327.

dividends derived from the profits in excess of the preferred percentage belong to the common stockholders.¹²⁶ If the statute provides that the company shall be bound to pay such dividends as may be expressed in the certificate, but not to exceed 5 per cent per annum, before any dividend shall be set aside or paid on the common stock, no more than 5 per cent may be paid on the preferred stock before a dividend is paid on the common stock, but after dividends are paid on the common stock, the preferred stock may participate in dividends to any amount.¹²⁷ Where the preferred stock is entitled to 6 per cent annual dividends "before any dividend shall be set aside or paid on the common stock," and the stock is cumulative, upon the declaration of a dividend of 54 per cent upon the preferred stock, upon which no dividend had been paid for nine years, and a like amount upon the common stock, it was held that a preferred stockholder could restrain payment of the dividend to common stockholders. The court's decision was based on the theory that common stock was not entitled in any year to more than 6 per cent unless it shared the excess equally with the preferred stockholders, since each new year marks the beginning of a new dividend-paying period.¹²⁸

Cumulative and noncumulative preferred stock. Dividends upon preferred stock may be either cumulative or noncumulative. If the contract with the preferred stockholders does not specify whether dividends shall be cumulative or noncumulative, but entitles the preferred stockholders to a certain annual dividend, without making the dividends payable in each year dependent upon the profits of that year, the dividends on the preferred stock are cumulative.¹²⁹

If the preferred stock is cumulative, either expressly or impliedly, the effect will be that if the specified rate upon preferred stock is not paid in one year, there will be an arrearage which must be

¹²⁶ *Tennant v. Epstein*, supra (Note 87); *Equitable Life Assurance Soc'y v. Union Pac. R.R.*, supra (Note 39).

¹²⁷ *Star Publishing Co. v. Ball*, (1922) 192 Ind. 158, 134 N.E. 285.

¹²⁸ *Englander v. Osborne*, supra (Note 120).

¹²⁹ *Bank of America Nat'l Trust & Savings Ass'n v. West End C. Co.*, (1940) 37 Cal. App. (2d) 685, 100 P.(2d) 318; *Lockwood v. General Abrasive Co.*, (1924) 210 App. Div. 141, 205 N.Y.S. 511; *Levin v. Pittsburgh United Corp.* supra (Note 16).

made upon subsequent years before any dividends may be declared on the common stock.¹³⁰

If the preferred stock is noncumulative and dividends have not been declared upon the stock, the dividends omitted in any year do not accumulate and need not be made up, even if they were earned for the year in which the dividend had been omitted. This is the rule established by a decision of the Supreme Court of the United States.¹³¹ Prior to this case, it had been held that noncumulative preferred dividends, when earned, accrued to the holders of preferred stock whether or not such dividends had been declared.¹³² However, the contract under which noncumulative preferred stock is issued may be so worded that the discretion of the directors in the declaration of dividends is controlled, and the interest of holders of noncumulative preferred stock in dividends earned may be protected.¹³³

Right of holders of part-paid stock to dividends. A mere subscriber to stock who has not paid for the stock in full is not entitled to participate equally with the shareholders whose stock is fully paid, in the absence of some provision in the charter, by-laws, or contract under which the subscription to stock is made.¹³⁴ However, where shares have been issued for stock that has been partly paid, the shares stand equally, irrespective of the fact that a larger amount has been paid upon some of them than upon others. The dividends

¹³⁰ See *Keller v. Wilson & Co.*, (1936) 21 Del. Ch. 391, 190 A. 115, holding that a corporation could not, by amending its certificate of incorporation, take away the right of preferred stockholders to payment of accrued dividends, where the statute at the time of issuance of the stock did not permit cancellation of accrued dividends. See however, *Harr. v. Pioneer Mechanical Corp.*, supra (Note 124).

¹³¹ *Wabash Ry. v. Barclay*, (1930) 280 U.S. 197, 50 S. Ct. 106; *Joslin v. Boston & Maine R.R.*, (1931) 274 Mass. 551, 175 N.E. 156. In both these cases the annual earnings were invested in capital improvements. In a similar case, except that the annual earnings were not invested in capital improvements, the court held that the directors might declare and pay dividends in subsequent years. *Collins v. Portland Elec. Power Co.*, (1926) 12 F.(2d) 671. See also *Guttman v. Illinois Central Ry.*, supra (Note 108).

¹³² *Collins v. Portland Elec. Power Co.*, supra (Note 131); *Morse v. Boston & Maine R.R.*, supra (Note 108); *Day v. U.S. Cast Iron Pipe & Foundry Co.*, (1924) 25 N.J. Eq. 389, 123 A. 546, aff'd, 96 N.J. Eq. 736, 126 A. 302.

¹³³ For a discussion of noncumulative preferred stock contracts in which the declaration of dividends is discretionary with the directors, and those in which the discretion is limited either as to time, amount, or both, see Stevens, "Rights of Non-Cumulative Preferred Stockholders," 34 COLUM. L. REV. 1439.

¹³⁴ *Baltimore City Passenger Ry. v. Hambleton*, (1893) 77 Md. 341, 26 A. 279; *Schwartz v. Manufacturers' Cas. Ins. Co.*, (1939) 335 Pa. 130, 6 A.(2d) 299.

must be divided among the shareholders in proportion to the nominal amounts of their shares, and not in proportion to the amounts respectively paid up on the shares.¹³⁵

A corporation that has a surplus has the power, as between itself and its stockholders, to agree that a dividend declared from such surplus shall be applied to the payment of subscriptions. A corporation that agrees to treat stock as fully paid in consideration of the surrender by the stockholders of accumulated profits, cannot later disturb the arrangement in its own behalf or in behalf of subsequent creditors with notice.¹³⁶

Corporations selling stock on the installment plan have made various arrangements for the payment of dividends and the charging of interest. Under a plan used by the American Telephone & Telegraph Co., the applicant's account was charged with the cost of the stock at the price at which the application for stock was accepted and credited with installment payments made by the applicant; at the time of final payment, it was credited with dividends to which the shares were entitled. Interest was charged to the applicant's account at the time of final payment at the rate of 6 per cent per annum, monthly installment payments made on or before the fifth of the month being treated as paid on the first day of the month, and those paid after the fifth of the month being treated as paid on the first day of the following month. The Associated Gas & Electric Co., which sold its stock on a monthly payment plan, allowed interest on each monthly payment at the rate of 6 per cent per annum from the first day of the month on payments received before the fifth of the month; otherwise interest was allowed from the first day of the month following, and an adjustment of the accrued dividend was made in connection with the final payment.

Another corporation that sold stock to employees on the installment plan issued the stock to the employees as fully paid under an arrangement by which a bank paid the purchase price. The employees executed notes for the unpaid portion beyond the initial installment. All of the stock was kept in pledge until the notes

¹³⁵ *Gellerman v. Atlas Foundry, etc. Co.*, (1906) 45 Wash. 114, 87 P. 1059. But see *Richardson v. Vermont, etc. R.R.*, (1872) 44 Vt. 613, 621.

¹³⁶ *Kenton Furnace R.R. & Mfg. Co. v. McAlpin*, (1880) 5 Fed. 737.

were paid off. The notes of the employees were guaranteed by officers of the corporation, who turned over to the bank securities which they themselves owned. All the dividends were paid to the bank in behalf of the stockholders and were applied against the unpaid purchase notes. Interest was charged on the notes at the rate of 6 per cent, which was less than the rate of dividend paid on the stock. In this way, the stockholder obtained full advantage of the dividend and was obligated to pay legal interest on the unpaid portion of the purchase price.

Right of stockholders of record to dividends. Dividends must be paid to the person in whose name the stock was registered on the corporate books at the date of the dividend declaration,¹³⁷ or at the record date if one has been fixed.¹³⁸

This rule applies even where the dividend is made payable on some later date,¹³⁹ and without regard to when the earnings were accumulated.¹⁴⁰ The corporation need not look beyond its books to determine who is entitled to dividends.¹⁴¹ However, if the corporation's books are erroneous through its own fault, it will be compelled to pay the dividend to the rightful owner.¹⁴² Furthermore, in the absence of a binding statute or by-law, the corporation will not be protected in the payment of a dividend to a registered holder if it has notice of the transfer from the registered holder to another.¹⁴³ The

¹³⁷ *Richter & Co. v. Light*, *supra* (Note 2); *Nutter v. Andrews*, (1923) 246 Mass. 224, 142 N.E. 67; *In re Heller's Estate*, (1952) 14 N.J. Super. 152, 81 A.(2d) 418; *Matter of Wanzer's Estate*, (1942) 177 N.Y. Misc. 929, 32 N.Y.S.(2d) 467.

¹³⁸ The practice of fixing a record date as a means of determining which holders are entitled to receive dividends was primarily designed for the protection of the corporation. Recently, however, the tendency has been to regard the record date as controlling in determining rival claims of dividend ownership as well.

¹³⁹ *In re Depew's Estate*, (1943) 179 N.Y. Misc. 1074, 41 N.Y.S.(2d) 19; *Matter of Wolfe's Estate*, (1935) 155 N.Y. Misc. 190, 279 N.Y. Supp. 605, 612; *Hill v. Newichawannick Co.*, (1876) 8 Hun. (N.Y.) 459, *aff'd* 71 N.Y. 593.

¹⁴⁰ *Hansen v. Bear Film Co.*, (1945) (Cal. App.) 158 P.(2d) 779; *Smith v. Taecker*, (1933) 133 Cal. App. 351, 24 P.(2d) 182. See *Munro v. Mullen*, (1956) (N.H.) 121 A.(2d) 312; *Blandin v. United North and South Development Co.*, (1956) (Del.) 121 A.(2d) 686.

¹⁴¹ *Brisbane v. D. L. & W. R.R.*, (1883) 94 N.Y. 204.

¹⁴² *Ashton v. Zeila Mining Co.*, (1901) 134 Cal. 408, 66 P. 494; *Blooming-Grove Cotton Oil Co. v. First Nat'l Bank*, (1900) (Tex. Civ. App.) 56 S.W. 552. Where corporation paid dividends to the wrong person for ten years by mistake, and on application of such person that the stock had been lost, issued new stock to him and paid dividends thereon for another ten years, it was held that the real owner was entitled to recover such dividends from the corporation. *Holly Sugar Co. v. Wilson*, (1938) 101 Colo. 511, 75 P.(2d) 149, criticized in 13 WASH. L. REV. 334.

¹⁴³ *Guarantee Co. v. East Rome Town Co.*, (1895) 96 Ga. 511, 23 S.E. 503; *Baar v.*

corporation in that case will remain liable to the transferee even if the latter failed to have the transfer registered. If the proper officers of the corporation have knowledge of the transfer, from some source other than the corporate books, this may constitute notice to the company.¹⁴⁴ But if the corporate officer has obtained the knowledge while acting for his individual benefit, and not in behalf of the corporation, the corporation is not chargeable with such knowledge.¹⁴⁵ The corporation may pay dividends to a record owner of stock who claims to have lost his certificate, and it will not be liable to the holder of the lost certificate for the dividends paid to the record holder.¹⁴⁶

Many large corporations appoint an agent, usually a trust company, to take care of the details involved in the payment of dividends, such appointment being made usually by a resolution of the board of directors (see Chapter 27).

Right to dividends as between purchaser and seller of stock. Before a dividend is declared, the intangible right to share in the earnings of the corporation is a mere incident to the stock and passes with it at a sale. But once the dividend is declared, it constitutes a property interest separate from the stock, and on a sale does not pass as an incident to it.¹⁴⁷ Thus, in the absence of a provision in the contract of sale to the contrary, a purchaser of stock is not entitled to dividends already declared, even though the dividends are not payable until a date after the sale has taken place.¹⁴⁸ (For the right to a dividend when it is declared on one date, payable at a later date to stockholders of record at an intermediate date, see page 1159.) If, as

Fidelity & Columbia Trust Co., (1946) 302 Ky. 91, 193 S.W.(2d) 1011; *Lunt v. Genesee Valley Trust Co.*, (1937) 162 N.Y. Misc. 859, 297 N.Y. Supp. 27.

¹⁴⁴ *Guarantee Co. v. East Rome Town Co.*, supra (Note 143).

¹⁴⁵ *Fourth Nat'l Bank v. Manchester Real Estate & Mfg. Co.*, (1915) 77 N.H. 481, 93 A. 661.

¹⁴⁶ *Turnbull v. Longacre Bank*, (1928) 249 N.Y. 159, 163 N.E. 135; *Brisbane v. D. L. & W. R.R.*, supra (Note 141).

¹⁴⁷ *Ford v. Snook*, (1923) 205 App. Div. 194, 199 N.Y. Supp. 630, aff'd, memo dec., 240 N.Y. 624, 148 N.E. 732, citing *Wheeler v. Northwestern Sleigh Co.*, (1889) 39 F. 347; *In re Depew's Estate*, supra (Note 139). See also Note 165, infra.

See also *Koppel v. Middle States Petroleum Corp.*, (1950) 197 N.Y. Misc. 479, 96 N.Y.S.(2d) 38, in which it was held that the right of action to recover wrongfully withheld undeclared dividends passes as an incident of the stock certificate transfer.

¹⁴⁸ *First Nat'l Bank & Trust Co. v. Glenn*, (1941) 36 F. Supp. 552; *Nutter v. Andrews*, supra (Note 137); *Hopper v. Sage*, (1889) 112 N.Y. 530, 20 N.E. 350.

a matter of custom or usage on a stock exchange, the rule prevails that dividends already declared and not paid pass with the stock, and the seller has actual knowledge of this custom, or knowledge that may be implied from his awareness of the fact that his agent would trade through the exchange, the seller will be bound by the rules.¹⁴⁹

Any dividend declared subsequent to a sale of stock belongs to the purchaser of the stock.¹⁵⁰ Thus, if there is a binding agreement to sell stock and a dividend is declared between the time the agreement to sell is made and the delivery of the certificates, the dividend belongs in equity to the purchaser and not to the seller.¹⁵¹ In the absence of an agreement to the contrary, even though the shares are not transferred upon the books of the company before they are closed, owing to the neglect of the seller to make prompt delivery of the securities, the seller is bound to turn over to the purchaser of stock,¹⁵² the dividend received by him from the corporation, or an equivalent amount. When a dividend is declared between the day of the sale and the day set for payment for the stock, the dividend belongs to the purchaser of the shares, in the absence of an agreement to the contrary.¹⁵³

If stock is sold at a fixed price "plus accrued dividends," the stipulated price per share of the stock is increased by a sum equivalent to the dividend rate from the date of the last dividend date to the date when the sale takes place. Such a contract imposes on the buyer the obligation to pay such dividend rate to the time of the sale, in addition to the price specified.¹⁵⁴

If there is a dispute between the transferor and the transferee as to who is entitled to the dividends, and the corporation knows of the

¹⁴⁹ *Ford v. Snook*, *supra* (Note 147). But see Note 165, *infra*.

¹⁵⁰ *Sautbine v. Stroud*, (1925) 5 F.(2d) 809; *Brower v. Fenner & Beane*, (1939) 237 Ala. 632, 188 So. 240; *Whitney v. Nolan*, (1937) 296 Mass. 419, 6 N.E.(2d) 386; *Lunt v. Genesee Valley Trust Co.*, *supra* (Note 143); *Hubbard v. George*, (1918) 81 W. Va. 538, 94 S.E. 974.

¹⁵¹ *Smith v. Taecker*, *supra* (Note 140), reviewed in 22 CALIF. L. REV. 353; *Whitney v. Nolan*, *supra* (Note 150); *Thompson v. Exchange Bldg.*, (1928) 157 Tenn. 275, 8 S.W. (2d) 489.

¹⁵² *Richter & Co. v. Light*, *supra* (Note 2).

¹⁵³ *La Fountain & Woolson Co. v. Brown*, (1917) 91 Vt. 340, 101 A. 36; *Hubbard v. George*, *supra* (Note 150).

¹⁵⁴ *Kennedy Bros. v. Bird*, (1934) 287 Mass. 477, 192 N.E. 73.

dispute, it can impound all dividends until the dispute is settled.¹⁵⁵

Right to dividends upon pledge of stock. Upon the pledge of stock as collateral security for a debt, the pledgee obtains, as an incident to his special ownership, the right to receive dividends. It is his duty to apply such dividends to the debt for which the stock is pledged, or to hold them in trust for the pledgor.¹⁵⁶ This is the rule as to dividends in the absence of some agreement between the pledgee and the pledgor to the effect that the right to collect dividends shall remain with the pledgor. The corporation must pay the dividends to the pledgee if the transfer has been registered on the corporate books or if the corporation has notice of the pledge;¹⁵⁷ otherwise it will become liable to the pledgee for any dividends paid to the pledgor.¹⁵⁸ The pledgee obtains no right to dividends declared prior to the pledge.¹⁵⁹

Closing the transfer books for payment of dividends. A corporation may close its transfer books temporarily for a reasonable time prior to the payment of a dividend in order to determine who shall receive a dividend. Should the corporation close its books for any purpose before a dividend is declared, those who apply for registry of their shares at or before the day of the declaration of the dividend are entitled to the dividend.¹⁶⁰ The books remain closed usually for a stated number of days, that is, for the period between the date as of which the dividend is declared and the dividend payment date. The result of the closing of the books is that the stockholders of record on the date the books are closed are entitled to the dividend.

On the New York Stock Exchange, transactions in shares are ex-

¹⁵⁵ *Perkins v. Benguet Consolidated Mining Co.*, (1942) 55 Cal. App. (2d) 720, 132 P.(2d) 70, cert. denied (1943) 319 U.S. 774, 63 S. Ct. 1435.

¹⁵⁶ *Head v. Sellers*, (1948) 251 Ala. 453, 37 So. (2d) 664; *Guarantee Co. v. East Rome Town Co.*, *supra* (Note 143).

¹⁵⁷ *First Nat'l Bank v. Wellborn*, (1939) 237 Ala. 183, 186 So. 549; *Morrison v. Gulf Oil Corp.*, (1940) 189 Miss. 212, 196 So. 247.

¹⁵⁸ *Guarantee Co. v. East Rome Town Co.*, *supra* (Note 143). But see *Mandel v. North Hudson Inv. Co.*, (1933) 112 N.J. Eq. 144, 164 A. 455, where the opposite conclusion was reached. See also *Bogardus v. Kentucky State Bank*, (1955) (Ky.) 281 S.W. (2d) 904, in which it was held that the pledgee of stock can recover a liquidating dividend from the trustee of a dissolved corporation who paid the dividend to pledgor without requiring surrender of the stock certificates.

¹⁵⁹ *Fairbanks v. Merchants' Nat'l Bank*, (1889) 132 Ill. 120, 22 N.E. 524.

¹⁶⁰ *Jones v. Terre Haute, etc. R.R. Co.*, (1874) 57 N.Y. 196.

dividend on the day of the closing of the books for dividends, except transactions made specifically for cash. Should the closing of the transfer books occur upon a holiday or half-holiday observed by the exchange, the rule applies for the preceding business day.

Declaring dividends without closing transfer books. The closing of the transfer books, especially by large corporations, involves considerable inconvenience, and corporations therefore prefer to declare dividends to stockholders of record on a certain date, payable at a later date, without closing the transfer books. Many of the statutes state that, unless otherwise provided by the articles or by-laws, the board of directors may fix a time, not exceeding a certain number of days preceding the date fixed for the payment of any dividend, as a record date for the determination of the stockholders entitled to receive any dividend, and in such case any shareholders of record on the date so fixed shall be entitled to receive such dividend, notwithstanding any transfer of any shares on the books of the corporation after any record date fixed by the board. In the absence of provision to the contrary, it would seem that the corporation may make such an arrangement in its charter, by-laws, or in the resolution declaring the dividend. To prevent uncertainty and confusion in business transactions, to determine definitely the rights and obligations of the corporation to its present and future stockholders, and to fix accurately the status of each of them toward the corporation and toward each other, the resolution declaring the dividend should state distinctly that the dividend is payable on a certain day to stockholders of record at the close of business on a certain previous day.

Where dividends are payable without the closing of the stock transfer books, a list of stockholders as of the record date is prepared from the stock record and certified. This list governs the distribution of the dividends. Reference is made to the stock books in case any question arises. By fixing the record date as of which stockholders are entitled to dividends, the corporation automatically fixes the date when the debt created by the declaration of the dividend accrues.¹⁶¹ The debt exists from the time of the declaration of

¹⁶¹ Geo. Feick & Sons Co. v. Blair, (1928) 26 F.(2d) 540.

the dividend, although payment may be postponed for the convenience of the company.¹⁶²

When the dividend is declared on one date, payable at a later date to stockholders of record at an intermediate date, the corporation pays the dividend to the stockholders of record at the intermediate date fixed in the resolution, rather than at the date of declaration.¹⁶³ However, the authorities are in conflict as to who has the legal right to the dividend, as between transferor and transferee, when title to the stock is transferred between the date of declaration and the record date fixed in the resolution.¹⁶⁴ The majority opinion is that the right to the dividend accrues at the time the dividend is declared. The provision in the declaration that the dividend is payable to stockholders of record at a future date is for the protection of the corporation, and does not affect the beneficial ownership of the dividend.¹⁶⁵ The corporation may not fix as the record date for determining who shall be entitled to dividends, a date prior to the passage of the resolution; in the event that the corporation does so, the stockholders on record as of the day the resolution is passed will be considered entitled to the dividend.¹⁶⁶

Notice of dividends declared and dividends passed. Although notice of the declaration of a dividend is not required to be sent to stockholders, it is generally desirable that written or published notice be given, in order that stockholders who are contemplating the sale of their shares may make the sale with an accurate knowledge of the dividend situation. Directors are not required to notify stockholders that a regular dividend will be "passed," that is, omitted. Frequently directors include in the minutes of the meeting their reasons for failing to declare a regular dividend, but such a record is not required, since the dividend cannot be paid without a

¹⁶² *Wheeler v. Northwestern Sleigh Co.*, (1889) 39 F. 347.

¹⁶³ *Burroughs v. North Carolina R.R.*, (1872) 67 N.C. 366.

¹⁶⁴ See Graham, "When Do Dividends Vest?" 27 GEO. L.J. 74 (1938).

¹⁶⁵ *First National Bank & Trust Co. v. Glenn*, *supra*, (Note 148) citing 38 HARV. L. REV. 245 and *Ford v. Snook*, *supra* (Note 147); *In re Wanzer's Estate*, (1942) 177 N.Y. Misc. 929, 32 N.Y.S.(2d) 19. But see *In re Bashford's Estate*, (1942) 178 N.Y. Misc. 951, 36 N.Y.S.(2d) 651. This case held that the dividends belong to the stockholders of record at the date fixed in the resolution, rather than at the date of declaration; that the New York statute as amended in 1930 completely nullified the *Ford v. Snook* (*supra*) rule.

¹⁶⁶ *Jones v. Terre Haute, etc. R.R.*, *supra* (Note 97).

resolution authorizing its declaration. As a matter of good practice, corporations that find it advisable to pass a dividend after a regular dividend has been established, send notice to their stockholders and give the reasons for the passing of the dividend.

Revocation of dividends, in general. When a dividend is declared, it becomes a debt of the corporation to the individual stockholders.¹⁶⁷ On the principle that a debtor cannot rescind his debt without the consent of the person to whom he is indebted, a corporation generally cannot revoke the declaration of a dividend without the consent of the stockholders.¹⁶⁸ This rule applies even though the declaration provides that the dividend shall be paid in such installments as the directors see fit.¹⁶⁹ If the corporation, by the deposit of funds out of which the dividend is to be paid, has become not only a debtor but a trustee, the board of directors cannot terminate the trust relation by a resolution rescinding its action in declaring the dividend and in setting aside the fund established for its payment.¹⁷⁰ Under the following circumstances, however, a dividend is revocable:

1. If the directors discover that they have mistakenly declared a dividend that impairs the capital of the corporation, they may rescind their action.¹⁷¹
2. If the declaration of the dividend has not been made public, and no fund has been set aside for the payment of the dividend, the directors may revoke the dividend.¹⁷²
3. If, after a dividend has been declared and before a fund has been created for its payment, the corporation experiences some unforeseen loss that makes it inadvisable for the corporation to pay the dividend, the directors may rescind it. For example, if, after the

¹⁶⁷ *United States v. Southwestern Portland Cement Co.*, supra (Note 15); *Smith v. Taecker*, supra (Note 140); *State v. Nebraska State Bank*, (1932) 123 Neb. 289, 242 N.W. 613; *In re Central New Jersey Land & Improvement Co.'s Dissolution*, (1933) 113 N.J. Eq. 332, 166 A. 705.

¹⁶⁸ *Grant v. Ross*, (1896) 100 Ky. 44, 37 S.W. 263; *McLaran v. Crescent Planing Mill Co.*, (1906) 117 Mo. App. 40, 93 S.W. 819.

¹⁶⁹ *Commissioner v. Cohen*, (1941) 121 F.(2d) 348.

¹⁷⁰ *Staats v. Biograph Co.*, (1916) 236 F. 454; *Van Dyck v. McQuade*, supra (Note 9).

¹⁷¹ *Benas v. Title Guaranty Trust Co.*, (1924) 216 Mo. App. 53, 267 S.W. 28.

¹⁷² *United States v. Southwestern Portland Cement Co.*, supra (Note 15); *Ford v. Easthampton Rubber Thread Co.*, (1893) 158 Mass. 84, 32 N.E. 1036. But see *McLaran v. Crescent Planing Mill Co.*, supra (Note 168), declining to follow *Ford v. Easthampton Rubber Thread Co.*

declaration of a dividend and before its payment, a fire should occur, causing tremendous loss, the directors would be justified in revoking the dividend if, in their honest judgment, the earnings intended for the distribution in dividends were necessary for the rehabilitation of the company.¹⁷³ Thus it has been held that directors of a corporation which had declared a scrip dividend about the time the First World War broke out, were permitted to revoke the dividend, when it appeared that the war had seriously affected the business of the corporation.¹⁷⁴

Revocation of stock dividends. In the revocation of a dividend, a distinction is made between a cash dividend and a stock dividend. If the stock dividend involves an increase of the corporation's nominal capital, the directors may revoke the stock dividend at any time prior to the actual issuance of the stock.¹⁷⁵ However, if the stock dividend is payable in shares that the corporation has acquired by purchase, the dividend would not be revocable¹⁷⁶ except under the circumstances indicated in the preceding paragraph, since no increase in the corporation's nominal capital is involved in the distribution.

Compelling the declaration of dividends. The general rule is that, in the absence of an express provision, binding upon creditors, that gives the stockholders a lien on the net income and earnings of a corporation, stockholders are not entitled, as a matter of right, to the distribution of net earnings through dividends.¹⁷⁷ Stockholders may compel the declaration of a dividend under the following circumstances: (1) if the statute¹⁷⁸ or contract under which the stock is issued requires the directors to pay dividends to the stockholders in each year in which there are sufficient earnings; and (2) if the stockholders seeking to compel the declaration of a dividend can show, in

¹⁷³ *Dock v. Schlichter Jute Cordage Co.*, (1895) 167 Pa. 370, 31 A. 656.

¹⁷⁴ *Staats v. Biograph Co.*, *supra* (Note 170).

¹⁷⁵ *Staats v. Biograph Co.*, *supra* (Note 170); *Terry v. Eagle Lock Co.*, (1879) 47 Conn. 141; *McLaran v. Crescent Planing Mill Co.*, *supra* (Note 168).

¹⁷⁶ *Dock v. Schlichter Jute Cordage Co.*, *supra* (Note 173).

¹⁷⁷ *Harris Trust & Savings Bank v. Chicago Rys.* (1932) 56 F.(2d) 942; *Kelly v. Galloway*, (1937) 156 Ore. 301, 66 P.(2d) 272; *Green v. Philadelphia Inquirer Co.*, (1938) 239 Pa. 169, 196 A. 32.

¹⁷⁸ *Amick v. Coble*, (1943) 22 N.C. 484, 23 S.E.(2d) 854. The North Carolina Business Corporation Act (effective 1957) provides that if a corporation pays less than one-third of its net profits for the year in dividends, holders of 20 per cent of the stock of an aggrieved class can compel payment [§55-50(i)].

a court of equity, in which such an action must be brought,¹⁷⁹ that the directors have acted fraudulently, oppressively, or unreasonably in refusing to declare a dividend when the corporation has a surplus distributable among its shareholders without detriment to the business.¹⁸⁰ The courts will not interfere, however, with the discretion of the directors if the latter have acted in good faith, without fraud, without abuse of discretion, and in a manner that is not unjust or oppressive to minority stockholders.¹⁸¹

The mere fact that there is in existence a large corporate surplus is not sufficient to warrant equitable intervention.¹⁸² However, in an action to compel the declaration of dividends, the stockholder must show, among other things, that there is a present surplus or net profit from which dividends may be declared.¹⁸³

The courts will not entertain an action for dissolution simply because the corporation has failed to pay a dividend. This is not regarded as "oppressive" conduct on the part of the directors.¹⁸⁴ But if the directors have, either improperly or negligently, failed to declare a dividend, the court, if it has jurisdiction over the corporation but not over a majority of the directors, may order a dividend declaration and it may sequester corporate assets for that purpose.¹⁸⁵

¹⁷⁹ *Rubens v. Marion-Washington Realty Corp.*, (1945) 116 Ind. App. 55, 29 N.E.(2d) 907; *Knight v. Alamo Mfg. Co.*, (1916) 90 Mich. 223, 157 N.W. 24; *Jones v. Van Heusen Charles Co.*, (1930) 230 App. Div. 694, 246 N.Y.S. 204.

¹⁸⁰ *Eshleman v. Keenan*, (1937) 22 Del. Ch. 82, 194 A. 40, aff'd (1938) 23 Del. Ch. 234, 2 A.(2d) 904; *W. Q. O'Neill Co. v. O'Neill*, (1940) 108 Ind. App. 116, 25 N.E.(2d) 656, discussed in 28 GEO. L.J. 1135; *Dodge v. Ford Motor Car Co.*, (1919) 204 Mich. 459, 170 N.W. 668; *Gaines v. Long Mfg. Co.*, (1951) 234 N.C. 331, 67 S.E.(2d) 350, 355; *Blair v. Bishop's Restaurants, Inc.*, (1950) 202 Okla. 648, 217 P.(2d) 161. See also *Patton v. Nicholas*, (1955) 154 Tex. 385, 279 S.W.(2d) 848, in which the court proposed the following remedy for a minority stockholder against recalcitrant directors for payment of dividends: (1) a mandatory injunction requiring the corporation to pay a substantial dividend at the earliest practical date; (2) annual dividends thereafter; (3) the court to retain jurisdiction for five years; and (4) if the injunction is violated, the corporation to be liquidated.

¹⁸¹ *Schnell v. Alston Mfg. Co.*, (1906) 149 F. 439; *NY PA NJ Utilities Co. v. Public Serv. Comm'n*, (1938) 23 F. Supp. 313; *Schmitt v. Eagle Roller Mill Co.*, (1937) 199 Minn. 382, 272 N.W. 277, discussed in 21 MINN. L. REV. 849; *Laredef Corp. v. Federal Seaboard Terra Cotta Corp.*, (1942) 131 N.J. Eq. 368, 25 A.(2d) 433; *Liebman v. Auto Strop Co.*, (1926) 241 N.Y. 427, 150 N.E. 505; *Green v. Philadelphia Inquirer Co.*, *supra* (Note 177).

¹⁸² *Marks v. American Brewing Co.*, (1910) 126 La. 666, 52 So. 983; *Daniels v. Briggs*, (1932) 279 Mass. 87, 180 N.E. 717; *Schmitt v. Eagle Roller Mill Co.*, *supra* (Note 181); *Ochs v. David Maydole Hammer Co.*, (1930) 138 N.Y. Misc. 665, 246 N.Y.S. 539.

¹⁸³ *Steele v. Locke Cotton Mills Co.*, (1950) 231 N.C. 458, 58 S.E.(2d) 620.

¹⁸⁴ *Central Standard Life Ins. Co. v. Davis*, (1957) 10 Ill. (2d) 566, 141 N.E.(2d) 45.

¹⁸⁵ *Kroese v. General Steel Casting Corp.*, (1950) 179 F.(2d) 760, cert. denied, 339

There are conflicting decisions as to whether an action in equity to compel the declaration of a dividend is "derivative" or "representative." The New York Court of Appeals held the action to be derivative.¹⁸⁶ It reasoned that the suit was one to enforce a cause of action on behalf of the corporation against the directors for failure to perform their official function. A federal court, applying the law of Pennsylvania, rejected the New York view and held the action to be representative.¹⁸⁷ It reasoned that the shareholders had suffered a direct injury, apart from any injury ostensibly suffered by the corporation, as a result of the director's improper refusal to declare a dividend. The distinction between derivative and representative suits is significant since some states require a stockholder who sues derivatively to post security for expenses.

Compelling payment after a dividend has been declared. The effect of a declaration of a dividend is the separation from the property of the corporation of as much of the earnings as is equal to the dividend declared. A stockholder has a right to the dividend declared upon his stock, and if the corporation should refuse to pay it, he may bring an action against the corporation for its collection.¹⁸⁸ Stockholders are general creditors of the corporation after the declaration of a dividend, and in the event of bankruptcy of the corporation, they share pro rata with general creditors. If the corporation, upon the declaration of a dividend, has set aside a fund out of which the dividend is to be paid, this action creates a trust fund in the hands of the corporation, to be used for payment to the stockholders and in the event of bankruptcy, general creditors cannot reach the fund.¹⁸⁹ As a general rule, a stockholder cannot recover interest on a dividend after it has been declared, although he may be allowed interest after a demand and a refusal.¹⁹⁰

U.S. 983, 70 S. Ct. 1026, discussed in 26 IND. L.J. 79, 49 MICH. L. REV. 275, 29 N.C.L. REV. 51, 2 STAN. L. REV. 780; *Whittemore v. Continental Mills, Inc.*, (1951) 98 F. Supp. 387.

¹⁸⁶ *Gordon v. Elliman*, (1954) 306 N.Y. 456, 119 N.E.(2d) 331, criticized in Notes, 41 CALIF. L. REV. 546, 53 COLUM. L. REV. 437, 38 CORNELL L.Q. 244, 28 N.Y.U.L. REV. 432.

¹⁸⁷ *Knapp v. Bankers Securities Corp.*, (1956) 230 F.(2d) 717. See also *Miller v. Ortman*, (1956) (Ind.) 136 N.E.(2d) 17.

¹⁸⁸ *Independence Lead Mines Co. v. Kingsbury* (1949) 175 F.(2d) 983; *In re Given's Estate*, (1936) 323 Pa. 456, 185 A. 778.

¹⁸⁹ *In re Interborough Consol. Corp.*, (1923) 288 F. 332, cert. denied sub num. *Porges v. Sheffield*, (1923) 262 U.S. 752, 43 S. Ct. 700.

¹⁹⁰ *W. Q. O'Neill Co. v. O'Neill*, supra (Note 180); *J. G. Wilson Corp. v. Cahill*, (1929) 152 Va. 108, 146 S.E. 274.

A stockholder who leaves his dividend with the corporation is under no default, for he is not obligated to draw or to demand his dividend within any prescribed period. A dividend that has been declared is payable on demand, and the statute of limitations does not begin to run against a claim for dividends until demand is made therefor by the owner of the stock or someone acting in his behalf and the demand is refused.¹⁹¹ However, if the corporation indicates by act or word that it will not pay the dividend to the stockholder, the statute of limitations would be set in motion without a specific demand from the stockholder and refusal by the corporation.¹⁹²

Right of corporation to set off dividend against debt due. A corporation has the right to retain dividends due to a stockholder and to apply them against a debt that the stockholder owes to the corporation.¹⁹³ However, when the dividend is not declared until after the death of a stockholder, the corporation loses the right to set off such dividend against the debt of the deceased stockholder, inasmuch as, upon the stockholder's death, such dividend becomes an asset of the decedent's estate, payable to his personal representative, and distributable by him to the persons entitled thereto.¹⁹⁴ If the stock is transferred before the declaration of a dividend, the corporation may not set off a dividend against the transferee of the stockholder who is indebted to the corporation, if it has knowledge that the stock has been transferred, even if such transfer has not been recorded on the books.¹⁹⁵

Liability of directors for unlawful dividends. In most of the

¹⁹¹ *Cavitt v. Amsler*, (1922) (Tex. Civ. App.) 242 S.W. 246. But see *Jacques v. White Knob Copper & Development Co.*, (1940) 260 App. Div. 640, 23 N.Y.S.(2d) 326, in which the court held that the statute of limitations will bar recovery of dividends by a stockholder when the action was commenced more than six years after the dividends had become payable.

¹⁹² *Cavitt v. Amsler*, *supra* (Note 191).

Consideration should also be given the state laws of escheat. Property, including stock and dividends, which has been unclaimed for a specified number of years may be taken over by the state. See *Standard Oil Co. v. New Jersey*, (1951) 341 U.S. 428, 71 S. Ct. 822; *New Jersey v. American Sugar Refining Co.*, (1956) 20 N.J. 286, 119 A.(2d) 767; *State v. F. W. Woolworth Co.*, (1957) (N.J. Super.) 132 A.(2d) 550; *State v. United Steel Corp.*, (1952) 19 N.J. Super. 274, 88 A.(2d) 246.

¹⁹³ *Railroad Credit Corp. v. Hawkins*, (1936) 80 F.(2d) 818, cert. den., 298 U.S. 667, 56 S. Ct. 750; *J. G. Wilson Corp. v. Cahill*, *supra* (Note 190).

¹⁹⁴ *J. G. Wilson Corp. v. Cahill*, *supra* (Note 190).

¹⁹⁵ *Grafton v. North American Transp. & Trading Co.*, (1919) 216 Ill. App. 262; *Gemmell v. Davis*, (1892) 75 Md. 546, 23 A. 1032.

states, a personal liability to the corporation and to creditors for the declaration and payment of unlawful dividends is placed upon directors. In many states, fines and imprisonment may be imposed.¹⁹⁶ In the absence of statutory provision on the subject, the directors are liable to the corporation and to creditors if they unlawfully pay dividends out of capital.¹⁹⁷ Thus, if the directors act without any knowledge of the company's earnings and without any investigation of its affairs, they are liable for the declaration of dividends out of capital.¹⁹⁸ If the directors, acting in good faith and without negligence, declare a dividend that later results in an impairment of the capital stock, they cannot be held personally liable.¹⁹⁹

It has generally been held that the statute of limitations barring an action to enforce the directors' liability, begins to run from the time the right of action accrued and not from the time it was discovered.²⁰⁰

Liability of absent and dissenting directors. Provision is made in many of the statutes that directors who dissent from the declaration of a dividend, or who are absent at the time the dividend is declared, shall not be personally liable for dividends unlawfully paid. The statutory provisions of the particular state must be studied carefully to see what action, if any, is required to be taken by a director who was absent or who dissented from the payment of a dividend, in order to escape personal liability.

In the absence of statutory provision on the subject, the general rule as to the liability of a director for acts of his co-directors may be

¹⁹⁶ See statutory provisions in each state, collected in *Prentice-Hall Corporation*.

¹⁹⁷ *Boyd v. Schneider*, (1904) 131 F. 223, rev'g 124 F. 239; *Baker v. Mut. Loan & Inv. Co.*, supra (Note 16); *Cochran v. Shetler*, (1926) 286 Pa. 226, 133 A. 232.

¹⁹⁸ *Wesp v. Muckle*, (1910) 136 App. Div. 241, 120 N.Y. Supp. 976, aff'd memo dec., sub nom. *Wesp v. Strassenburgh*, (1911) 210 N.Y. 527, 94 N.E. 1100; *Baker v. Mut. Loan & Inv. Co.*, supra (Note 16).

¹⁹⁹ *Williams v. Spensley*, (1917) 251 Fed. 58; *Moore v. Murchison*, (1915) 226 F. 679; *Myers v. C. W. Tolcs & Co.*, (1939) 287 Mich. 340, 283 N.W. 603.

The statutes in some states specifically protect the directors from liability if they rely in good faith upon the books of account of the corporation or statements prepared by the corporation's officials or by the certified public accountants. See *Gallagher v. New York Dock Co.*, (1940) 19 N.Y.S.(2d) 789.

The statutes also limit the liability of directors to the extent that the capital was impaired. See *Irving Trust Co. v. Gunder*, supra (Note 31).

²⁰⁰ *McGill's Adm'x v. Phillips*, (1932) 243 Ky. 768, 49 S.W.(2d) 1025; *Pourroy v. Gardner*, (1932) 122 Cal. App. 521, 10 P.(2d) 815.

applied in determining the liability of directors who were absent when an illegal dividend was declared. An absent director will not be held liable for acts of his associates if he has not connived or participated in the acts, or if he was not negligent in failing to act.²⁰¹ A director is not required to attend every meeting of the board of directors and therefore may not ordinarily be held liable for acts in which he has not concurred.²⁰²

Upon learning of an illegally declared dividend, an absent director should inform the board of directors of his dissent from the act, if he wishes to escape liability for the acts of his co-directors. The general rule is that a director is held equally responsible with his associates when wrongful acts of the board have come to his knowledge, and when he acquiesces and takes no steps to avert the injurious consequences of the acts if, by due diligence, he might have prevented them from being done.²⁰³

Liability of stockholders to return dividends improperly paid. Illegal dividends paid to stockholders are generally recoverable by the corporation.²⁰⁴ If restitution is not enforced by the corporation, a stockholder or a creditor may file a bill in equity to compel repayment.²⁰⁵ One standing in the shoes of the creditors, such as a receiver of a corporation²⁰⁶ and a trustee in bankruptcy²⁰⁷ may take steps to recover illegally paid dividends, as may an assignee for the benefit of creditors where the right is included in the assignment.²⁰⁸

Stockholders who receive illegal dividends at a time when the corporation had an unpaid tax liability are chargeable with knowl-

²⁰¹ *Schout v. Conkey Ave. Saving Aid & Loan Ass'n*, (1895) 11 N.Y. Misc. 454, 32 N.Y.S. 713; *Watkinson v. Adams*, (1939) 187 Okla. 432, 103 P.(2d) 498.

²⁰² *Murphy v. Penniman*, (1907) 105 Md. 452, 66 A. 282.

²⁰³ *City Investing Co. v. Gerken*, (1924) 121 N.Y. Misc. 763, 202 N.Y.S. 41; *Schout v. Conkey Ave. Saving Aid & Loan Ass'n*, *supra* (Note 201).

²⁰⁴ *Grant v. Ross*, *supra* (Note 168); *Webb City Undertaking Co. v. Sinclair*, (1949) 240 Mo. App. 958, 225 S.W.(2d) 138.

²⁰⁵ *Gager v. Paul*, (1901) 111 Wis. 638, 87 N.W. 875. See also *Myers v. C. W. Toles & Co.*, *supra* (Note 199) which held that stockholders are not liable for illegal dividends where the provisions of the statute for enforcement of such liability had not been followed.

²⁰⁶ *Hayden v. Williams*, (1899) 96 Fed. 279.

²⁰⁷ *Ulness v. Dunnell*, (1931) 61 N.D. 95, 237 N.W. 208; *Cottrell v. Albany Card & Paper Mfg. Co.*, (1911) 142 App. Div. 148, 126 N.Y. Supp. 1070.

²⁰⁸ *Grant v. Ross*, *supra* (Note 168).

edge of the outstanding debt and are, therefore, liable for the full amount received by them.²⁰⁹

The liability of stockholders to return dividends illegally paid is not affected by the fact that the stockholder received the dividends in good faith and without knowledge that they had been illegally declared, according to the decisions of many of the courts on the question. However, the United States Supreme Court has held that a trustee in bankruptcy of a national bank could not recover from a stockholder a dividend paid out of capital while the corporation was not insolvent and was a going concern at the time of the payment, if the stockholder received the dividend in good faith and in the full belief that the corporation was solvent and prosperous.²¹⁰ Where the bank was insolvent at the time of the declaration of the dividend, the court held that the receiver could recover the illegal dividends from a stockholder who had received them in good faith.²¹¹ A stockholder who has received, in good faith, dividends that were declared without negligence by the directors while the corporation was solvent, cannot later be compelled to return such dividends merely because, due to unexpected reversals, the corporation becomes insolvent.²¹²

The liability on the part of stockholders to make restitution of illegally declared dividends is not discharged by a transfer of the shares after payment of the dividend. Nor does liability fall upon the transferee as a result of the transfer.²¹³ A stockholder who has received an illegal dividend is not exonerated from repayment for the benefit of creditors by virtue of a provision in the statute making the directors personally liable for repayment of unlawful dividends.²¹⁴

Rights of creditors who became such after payment of illegal dividends. According to some courts, the time when the creditor's claim arose does not affect his right to pursue his claim into the hands of recipients of an illegally paid dividend. He may recover

²⁰⁹ *United States v. Seyler*, (1956) 142 F. Supp. 408.

²¹⁰ *McDonald v. Williams*, (1898) 174 U.S. 397, 19 S. Ct. 743. See also *Ratcliff v. Clendenin*, (1916) 232 Fed. 61; *Bartlett v. Smith*, (1932) 162 Md. 478, 160 A. 440, 161 A. 509; *Quintal v. Adler*, (1933) 146 N.Y. Misc. 300, 262 N.Y. Supp. 126.

²¹¹ *Hayden v. Williams*, *supra* (Note 206); *Bartlett v. Smith*, *supra* (Note 210).

²¹² *Reid v. Eatonton Mfg. Co.*, (1869) 40 Ga. 98.

²¹³ *Hurlbut v. Taylor*, (1885) 62 Wis. 607, 22 N.W. 855.

²¹⁴ *Williams v. Boice*, (1884) 38 N.J. Eq. 364; *Powers v. Heggie*, (1929) 268 Mass. 233, 167 N.E. 314.

regardless of whether the debt was incurred before or after the illegal dividend declaration.²¹⁵ Other courts hold that creditors whose claims arose after the declaration of the illegal dividend cannot recover from stockholders if the dividend was declared while the corporation was solvent.²¹⁶

²¹⁵ *Georgia Power Co. v. Watts*, (1937) 184 Ga. 135, 190 S.E. 654; *Cottrell v. Albany Card & Paper Mfg. Co.*, *supra* (Note 207); *Williams v. Boice*, *supra* (Note 214).

²¹⁶ *Ratcliff v. Clendenin*, *supra* (Note 210).

CHAPTER 27

PROCEDURE IN PAYMENT OF DIVIDENDS

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Procedure in Payment of Dividends

Introduction. The following discussion of the practice followed by corporations in making dividend payments is divided into three distinct parts: (1) the procedure for a small corporation; (2) the procedure for a large corporation handling its own dividend payments; and (3) the procedure for a corporation employing a dividend disbursing agent. It will be noted that in many respects the systems are similar. Points of dissimilarity, are, however, sufficiently numerous to require separate explanations.

PROCEDURE IN SMALL CORPORATION

Outline of procedure. In a small corporation, the procedure for handling the payment of dividends is not detailed. In general, the secretary or other official in charge of the registration and transfer of securities handles most of the details of the dividend payment. The following are the steps ordinarily taken in the payment of a dividend by a small corporation:

1. At a meeting of the board of directors at which the declaration of a dividend is to be considered, the treasurer submits to the meeting a financial statement, showing earnings for the period under consideration (i.e., annual, semi-annual, quarterly, and so on) as well as a balance sheet for the period ending at or near the date as of which the dividend is to be declared. This information is prepared as a guide for the directors in determining whether the corporation, from a legal, as well as from a financial standpoint, may pay a dividend.
2. A resolution is passed declaring the dividend.¹
3. The secretary prepares, from the stock record book, a list of stockholders entitled to the dividend, showing the name and address

¹ For the information to be contained in the resolution, see page 1116; for forms of resolutions, see Chapter 12.

of each stockholder and the number of shares held. This list becomes the dividend payment record. The check number and the amount of dividend paid to each stockholder are entered on the record (Form 822).

4. Checks are made out to the persons shown on the dividend payment record, in the amounts there indicated.

5. Amounts shown on the checks are reconciled with the total amount indicated on the dividend payment record.

6. The secretary then submits to the treasurer of the company the dividend payment record and the dividend checks to be signed by the proper officers. Some corporations find it convenient to handle dividend payments through a separate bank account for the payment of dividends. In that case, a requisition will be sent to the treasurer for a check in the amount of the sum needed to pay the dividend, for deposit in the special dividend bank account.

7. The treasurer examines the dividend payment record to see that the total of the shares upon which dividends are being paid agrees with the amount of stock outstanding as shown on the corporate books. The dividend record and the signed checks are returned to the secretary. The amounts may also be balanced by dividing the total amount of dividends paid by the dividend per share and com-

..... COMPANY

Schedule of stockholders and shares owned at close of business,
....., 19.... Dividend of% (..... cents per
share), payable on, 19..., to stockholders of record on
....., 19..., at 3 P. M.

Name and Address	No. of Shares	Check No.	Amount
.....			
.....			
.....			

Form 822—List of stockholders, and dividend payment record.

paring the result with the total number of shares outstanding; the two amounts should, of course, agree.

8. The dividend checks are mailed. In small corporations, the need for an accompanying notice stating the purpose of the check is sometimes not considered important. However, in other corporations a notice explaining the check may be enclosed (Form 823).

Form 823—Notice accompanying dividend check.

....., 19.....
 THE COMPANY
 STREET
 CITY, ...

Enclosed herewith please find a check in payment of the quarterly dividend of six per cent (\$1.50 per share) on the shares of the capital stock of our Company, standing in your name.

Yours respectfully,

.....
 Secretary

No acknowledgment is necessary. Please notify us promptly of any change in your address.

9. If a dividend check is lost, returned “not found” by the post office department, or is not deposited within a reasonable length of time, the secretary will follow up to try to locate the holder, and induce him to cash the check, just as he would in the case of any other company check in similar circumstances.

➤➤➤**SUGGESTION**➔ At the end of the year, the company may give to each employee-stockholder a memorandum of the amount of dividends that he was paid during the year. It may do so by giving him a copy of Form 1099 on which the dividends were reported to the Internal Revenue Service.

***PROCEDURE IN LARGE CORPORATION HANDLING
 ITS OWN DIVIDEND PAYMENTS***

Need for an efficient system. Corporations having thousands of stockholders have found it necessary to install efficient systems for the payment of dividends, and to simplify procedures in order to attain the greatest possible speed and accuracy with the smallest staff prac-

ticable. The marked growth of the number of stockholders in recent years has greatly increased the volume of work for stock transfer and dividend disbursing departments. With the need thus created, there has come a rapid development of new equipment and procedures designed to mechanize these operations to the greatest possible extent.

These developments are proceeding so rapidly that any description of them is certain to be outdated in a short time. In the sections below, there is set out a description of the most commonly used methods, and of the basic features of general procedures. These are not likely to change rapidly, although details of application will.

Preliminary procedure—declaration of dividend. The preliminary procedure for the declaration of a dividend is practically the same for large and small corporations. At a regular or special meeting of the board of directors, called for the purpose of considering the declaration of a dividend, the treasurer presents a statement of earnings for the current dividend period and a balance sheet from which the directors determine whether or not a dividend may and should be declared. If the directors find that the corporation may legally declare a dividend, and believe that as a matter of business policy the dividend should be declared, they adopt a resolution declaring the dividend.² Publication of notice of declaration of the dividend and proper notice to the stock exchange are then attended to by the secretary of the corporation.³ Each quarterly dividend is assigned a consecutive number, and all forms used in connection with dividend payments bear that number; for example, instead of being identified as the dividend for the first quarter of 1959, that dividend is referred to by number, as "75th."

List of stockholders entitled to dividends. The resolution of the board of directors declaring the dividend indicates the date as of which stockholders of record shall be entitled to payment of the dividend. The corporation must have available a correct list of stockholders as of this record date. Where the corporation employs a transfer agent, the latter will furnish the list of stockholders of

² For the form of the resolution, see Chapter 12.

³ For forms of notice of declaration of dividends, see Form 847, *et seq.*

record on the day set for the determination of persons entitled to the dividend. Where the corporation handles its own stock transfers, its transfer department or the officer in charge of transfers will prepare the list of stockholders. This list is obtained from addressograph plates or stencils corresponding to the ledger of stockholders' accounts maintained by the department handling transfers of the corporation's stock.⁴

Addressograph plates or stencils. The addressograph department has on file an addressograph plate or stencil for each stockholder whose account appears in the stock ledger. These plates are used in making dividend payments, and they must agree exactly with the information in the stockholders' ledger as of the record date for the payment of dividends. Where the amount of stock held by the stockholder is shown in the addressograph plate, a total of the amounts shown on the plates is checked against the total of the amounts appearing in the stockholders' ledger.

Special dividend payment instructions. Ordinarily dividends are paid to those persons listed in the stock ledger as registered stockholders. However, the stockholder has the right to direct the corporation to pay the dividends to someone other than himself, or to mail the dividend checks to an address other than that shown on the stock record. This is sometimes referred to as a "dividend address." Upon receipt from the stockholder of a request for such special handling of dividend payments, some corporations send him a standard form, similar to that shown in Forms 824 and 825. Upon the return of the forms, the instructions are noted on the stock ledger, and a special stencil is made in accordance with the stockholder's instructions, to be used for making dividend payments.

Methods of disbursing dividends. Two time-tested methods of disbursing dividends are the register sheet method and the check stub method. However, the use of tabulating cards in conjunction with the register sheet method is in increasingly general use. Each of these three procedures is described below.

The register sheet method of dividend disbursement. The explanation that follows describes the register sheet method used by a

⁴ See page 1058 for a description of the method of maintaining a stockholders' ledger.

All in Address to which Checks are to be sent.	TO THE TREASURER OF THE _____ CORPORATION _____ _____ BROADWAY, NEW YORK, N. Y.	Date _____
	Please pay by check on New York, to the order of _____ and mail to address given in the margin all dividends due, and which may hereafter be due, on all PREFERRED AND COMMON STOCK of the _____ CORPORATION, that may at any time stand in my name on the books of the Corporation, until this order is revoked in writing.	
	Signature { _____	
	NOTE:—This order should be signed by the stockholder <i>personally</i> , and in the same manner as the name is written on stock certificate. When check is <i>not</i> to be drawn in favor of the stockholder the signature must be notarially acknowledged. See form on other side.	

Form 824—Permanent dividend order.

large corporation. Minor variations may occur in the system as used by other corporations, but the basic steps of the procedure will be the same.

1. *Preparing register sheets.* Form 826 shows a specimen register sheet. Each sheet contains space for the names and addresses of about twenty stockholders. The consecutively numbered sheets are run through the addressograph which prints on them the names and addresses of the stockholders.

Do not have signature acknowledged before a Notary Public unless you wish check made payable to the order of another person. No acknowledgment is necessary if checks are payable to a bank for your account.	
State of _____ County of _____	} ss.: On this _____ day of _____, 19____, before me personally came _____ _____ to me personally known to be the individual described in, and who executed the within order and he acknowledged to me that he executed the same.
 SEAL OF NOTARY PUBLIC 157-5064-1915	Signature of _____ Notary Public { _____
ATTESTING OFFICER MUST IMPRESS HIS SEAL. CERTIFICATION OF ATTESTING OFFICER'S AUTHORITY MUST BE ATTACHED.	

Form 825—Reverse of Form 824.

dividend checks equal to the number of names on one register sheet. The checks are run through the addressograph and printed with the names and addresses of the stockholders in the same order as they appear on the register sheets.

3. *Filling in number of shares on register sheet.* Some companies have the number of shares owned by a stockholder shown on the addressograph plate. In that case it has been printed on the register sheet and on the blank checks at operations 1 and 2, above. Otherwise, the number of shares owned by a stockholder is entered opposite his name on the register sheet from the ledger records. If a name appears on the register sheet for which there are no shares of record, it will be marked off.

4. *Check writing machine.* The register sheet and its corresponding check sheet, or strip, are inserted in a check writing machine simultaneously. The operator prints the check number and the amount of the dividend on both the check and the register sheet. The official signature of the proper corporate officer is printed on the check by means of a signature plate which is locked in the machine.

5. *Correction of checks.* As the checks are withdrawn from the machine they are examined to make sure that each check has been drawn for the amount called for by the number of shares shown for the stockholder on the register sheet, and that it has not been spoiled in the machine. Spoiled or incorrect checks are marked "Void" and are held aside. After all register sheets and checks have been run through the check writing machine, a register sheet is made up and checks drawn in place of those voided.

6. *Checking of totals.* The transfer department provides the disbursing department with a total of shares outstanding for each stock ledger division, and a grand total of all shares of stock outstanding. The disbursing department reconciles these totals with the totals shown on the register sheets (after adjustment for voided checks) and reconciles the dollar amount of dividends represented by these totals with the dollar amount of checks drawn. Three copies of the reconciliation statement are made. One is pasted on the last register sheet. One is held by the disbursing department. The third is sent to the treasurer with the voided checks.

7. *Cutting and mailing of checks—permanent dividend record.* The checks are cut apart. Voided and spoiled checks are punched “cancelled” and are attached to the treasurer’s copy of the reconciliation statement. The other checks are inserted in envelopes together with any other enclosures which are to go to the stockholder. The envelopes are then sealed and stamped. The register sheets are bound as a permanent record of the payment of the dividend.

8. *Changes of address.* Change of address notices which are received after the running of the dividend checks has begun are given effect and envelopes are typed accordingly. Otherwise the checks are mailed in window envelopes.

9. *Return of cancelled checks.* As dividend checks clear through the bank and are returned to the corporation, the date of such return is indicated on the register sheet. (See Form 826.) Follow-up letters are written to stockholders whose checks have not been returned to the corporation. The returned checks are kept at least until the statute of limitations has run on the debt. Some corporations keep them permanently.

Variations in register sheet method when punched card procedure is used. An increasingly large number of companies, particularly those having several thousand stockholders, use punch card procedures in the disbursement of dividends. It has been found that substantial reductions in cost are obtained by the use of punch cards. In principle these procedures are like those described in preceding sections, but they differ in detail. The following is a typical procedure.

1. Addressograph plates are maintained for all stockholder accounts. These plates are embossed with the stockholder’s name and address, and are punched with the share balance, stockholder’s number, and perhaps other coded information. These plates are at all times kept in reconciliation with the stock register record. This can be done by having one copy of the transfer posting ticket (see p. 1054) go to the addressograph department for appropriate change in the plate.

2. Punch card check forms are obtained from the manufacturer

with the check numbers pre-printed and pre-punched. A typical check is shown at Form 827.

3. These checks are run through the addressograph which prints the stockholder's name, address, and number, and, in some companies, his share balance.

4. The checks are sorted by share or alphabetical group and are again run through the addressograph, at which time, by the use of a different set of stencils, each check is printed and punched with the dividend amount. The checks may be signed at this operation, or may be signed later by a check signer machine.

5. The checks are then sorted by stockholder's number, and are run through an accounting machine which obtains totals of shares and dividend amounts by control group. These totals are balanced against totals established as of the record date, based on ledger card records.

6. Check register punch card forms are run through the addressograph, which prints on them the stockholder's name, address, and share balance, and which punches into the cards the dividend number, stockholder's number, and number of shares.

7. The checks and the check register cards are reconciled mechanically, and thereafter the check register cards are run through an interpreter which imprints them with the information represented by the holes previously punched in them.

8. The dividend checks, together with as many as three other inserts, are placed in window envelopes, and the envelopes are sealed, counted, and imprinted with the proper postage by an inserting and mailing machine.

9. Verification of the checks and the record punch cards can be made by machine collating and sorting. Similarly, as the cancelled dividend checks are returned by the bank, they are collated with the record punch cards, and an "Outstanding Check" record is made.

The check stub method of dividend disbursement. As in the register sheet method, the procedures adopted by corporations using the check stub method vary in details, but are basically the same. The principal difference between the two is that check stubs are used in place of, or in conjunction with, the register sheet. Described be-

low is the system used by a typical corporation that issues thousands of dividend checks annually.

1. *Filling in checks, stubs, and lists of stockholders.* The checks used are single. Each check has an attached stub. The checks are numbered in sequence, the stub bearing the same number as the check. See Form 828. Some companies that employ an outside dividend disbursing agent use a check with two stubs, one of which is retained by the agent, and the other by the company's transfer department. The two stubs are illustrated in Form 829. Companies

THE T _____ COMPANY NEW YORK, N. Y.	DIVIDEND NO 218	MARCH 9, 19__	1-2 210 132,000
III PAY TO THE ORDER OF	THE T _____ COMPANY VICE PRESIDENT AND TREASURER ASSISTANT TREASURER		
THE C _____ BANK			

Form 827—Typical punch card dividend check.

PAYEE OF A CHECKED CHECKER OF CREDIT AND DEBIT OF THE BANK AND VALUE OF A CHECKED CHECKER OF CREDIT, PAYABLE TO STOCK HOLDERS OF RECORD ON DECEMBER 31, 19__	PAYABLE AT TRUST COMPANY OF NEW YORK — BROADWAY NEW YORK, N. Y.	DIVIDEND CHECK No. 16 F 9012 NEW YORK, DECEMBER 18, 19__	C _____ COMPANY INCORPORATED 1-23 210
PAY TO THE ORDER OF			C _____ COMPANY DIVIDEND ACCOUNT TREASURER

Form 828—Form of dividend check used in stub method of dividend payments.

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PROCEDURE IN PAYMENT OF DIVIDENDS

using tabulating card checks, may use a tabulating card type of stub or record card.

The checks are run through the addressograph and the name and address of the stockholder are imprinted on the check and on the stub. The amount of the dividend is imprinted on both, at the same operation or by means of a separate run, depending upon the type of equipment used. At the same time this information may be

CASHIER'S STUB DIVIDEND CHECK NO. 16 F 9012 C. _____ COMPANY PAYABLE DECEMBER 15, 19____ AT _____ TRUST COMPANY OF NEW YORK _____ BROADWAY, NEW YORK, N. Y. AT \$ _____ PER SHARE	TRANSFER STUB DIVIDEND CHECK NO. 16 F 9012 C. _____ COMPANY PAYABLE DECEMBER 15, 19____ AT _____ TRUST COMPANY OF NEW YORK _____ BROADWAY, NEW YORK, N. Y. DIVIDEND FED. TAX WITHHELD
AMOUNT OF CHECK SHARES	AMOUNT OF CHECK AT \$ _____ PER SHARE SHARES

Form 829—Stubs attached to dividend check shown in Form 828.

printed on one or more copies of a long record sheet, like the one shown in Form 826. At the completion of the run, this sheet constitutes a permanent record of the stockholders receiving dividends, the number of shares owned, and the amount paid to each. Copies of

CHECK SUBSTITUTE CARD													
Held by _____ Amount \$ _____ No. _____ Name _____	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th colspan="2" style="text-align: center; padding: 5px;">REASON</th> </tr> <tr> <td style="padding: 5px;">Name Wrong _____</td> <td style="width: 20px; border: 1px solid black;"></td> </tr> <tr> <td style="padding: 5px;">Money Wrong _____</td> <td style="border: 1px solid black;"></td> </tr> <tr> <td style="padding: 5px;">Poor Printing _____</td> <td style="border: 1px solid black;"></td> </tr> <tr> <td style="padding: 5px;">Alignment _____</td> <td style="border: 1px solid black;"></td> </tr> <tr> <td style="padding: 5px;">Mutilation _____</td> <td style="border: 1px solid black;"></td> </tr> </table>	REASON		Name Wrong _____		Money Wrong _____		Poor Printing _____		Alignment _____		Mutilation _____	
REASON													
Name Wrong _____													
Money Wrong _____													
Poor Printing _____													
Alignment _____													
Mutilation _____													

Form 830—Check substitute card.

this record may be made the basis of reports to state tax agencies. The checks are signed by means of a signature plate locked in the machine, or by a check signing machine.

2. *Examination of checks.* A statement of the total shares and total dividend amounts has previously been prepared from the stock ledgers. The checks then are compared with the stock ledger cards. If any check is found to be incorrect, it is marked "Void" and a check substitute card, as shown in Form 830, is filled out, showing why the check was voided. If a check is found to be missing, a check requisition, as illustrated in Form 831, is prepared. These requisitions must be approved by the supervisor. New checks are made up on the addressograph as called for by the check substitute cards and the check requisitions. The number of shares represented by the checks and the amount of the dividends which they represent are reconciled against totals previously prepared from the ledger card records.

REQUISITION FOR ADDITIONAL CHECK	
Dividend No. _____	For Section _____
Check No. _____	
Name _____	Amount \$ _____
Address _____	

Approved _____	

Form 831—Requisition for additional check.

3. *Mailing of checks.* The stubs are detached from the checks and filed in alphabetical order. The checks are run through a conventional mailing machine which inserts them in envelopes together with any other material being mailed, seals the envelopes and stamps them with proper postage. Forms 832 and 833 indicate a form of notice which may accompany the check.

4. *Return of cancelled checks.* As checks clear through the bank and are returned to the corporation they are filed and the check

stubs are removed. Thus, at any given time the stubs remaining in the file represent checks that have not been cleared. They form the basis for "Outstanding Checks" reports and for follow-up letters to the stockholders who have not cashed their checks. Cancelled checks are retained until the statute of limitations has run on the debt, or longer.

Use of electronic data processing (automation) procedures in dividend payment. As pointed out above (Chapter 24, page 1073), standard electronic data processing (EDP) procedures have been adapted and applied to the transfer of stock and the maintenance of

U _____ CORPORATION — _____, NEW YORK, N. Y. <i>ON July 31, 19__, the directors declared a dividend of \$__ per share upon the Preferred Stock for the quarter ended June 30, 19__, being Dividend No. 224, payable this day to stockholders of record August 7, 19__.</i> <i>Enclosed is check for above dividend on the Preferred Stock standing in your name. No acknowledgment is necessary.</i> <i>To insure prompt receipt of checks, please notify the Stock Transfer Department, _____, New York, N. Y., of any change in your address. A form for your convenience is on the back hereof. Do not rely on merely notifying the Post Office, as such notice is kept on file only for a limited time.</i> New York, August 20, 19__. _____ Secretary (over)

Form 832—Typical notice mailed with dividend check.

U _____ CORPORATION, Stock Transfer Department — Broadway, New York, N. Y.		_____ 19__ (DATE)
Please change my address: From _____ To _____ (STREET) (STREET)		
(CITY) _____ (ZONE) _____ (STATE) _____	(CITY) _____ (ZONE) _____ (STATE) _____	
Number of Shares: _____ Pfd. _____ _____ Com. Share Owner's Name _____ (SIGNATURE) (PRINT)		
Postal zone numbers, where they have been assigned, must be shown to assure prompt delivery. 564-9-606-436 (over)		

Form 833—Reverse of Form 832.

stock transfer records. There is a definite trend toward a similar application of such procedures to the payment of dividends. As the use of electronic equipment in office procedures increases, and the cost of the equipment is reduced, it is to be expected that more companies will avail themselves of the advantages of using it for stock transfer and dividend disbursement.

The following description of the procedures followed in one company is typical of the methods employed by others. In this company all of the stock ledger card information was transferred to punch cards, and from them to a magnetic tape. The record is maintained on the tape alphabetically by stockholder's name. The information stored on the tape includes: the stockholder's name, his mailing address, his dividend address, his account number, which is also his permanent dividend check number, the number of shares he owns, and the amount of the dividend. It is further coded to show the class of stock held, a geographic code, and similar information. In addition, the tape contains a complete record of all of the activity of the stockholder's account. Punch cards are prepared from posting slips sent to the EDP department by the stock transfer department. Periodically, the changes represented are added to the tape record. At dividend time, all changes are recorded as of the dividend record date, and a new tape is run consolidating all changes accumulated and recorded since the last dividend date. From the new tape a record is run. It is printed on pages about 12 x 15 inches, each page containing the record of about twelve stockholder accounts. The record includes: the stockholder's name and address, certificate number, number of shares, debits and credits, and account number. This record becomes the ledger record and replaces the ledger cards. The tape is run from the magnetic tape unit to a machine which automatically makes punch cards reflecting all of the information that is to appear on the dividend checks. As these cards are run through an automatic printing machine, the checks are printed and signed. The checks, which are printed on continuous tabulating card forms, are then sent to the stock transfer department where they are separated and mailed to the stockholders, with various enclosures, by conventional inserting and mailing machine process. The controls, proce-

dures for accounting for and replacing voided checks, and records of checks mailed are like those described above for other methods of disbursement.

Reporting payment of dividends to Internal Revenue Service. The federal income tax law⁶ requires corporations to report the payment of annual dividends of \$10 or more to any one stockholder. The Service's Form 1099 is made out for each stockholder after the first quarter's dividend is paid. Subsequent dividends are accumulated. After all dividends for the year have been recorded on the forms, those that total \$10 or more are summarized on Form 1096. Form 1096 and all Forms 1099 are sent to the nearest Internal Revenue Service Center, on or before February 28 of the following year. Quarterly reports are permitted. Building and loan associations, cooperative banks, homestead associations, credit unions, and savings and loan associations need file Form 1099 only when the distribution is \$600 or more.

DIVIDEND NUMBER 218 Payable March __, 19__		CHECK NO. 132,000
AMOUNT PAID	NUMBER OF SHARES HELD	
TO WHOM PAID	FORM 1099 TREASURY DEPARTMENT INTERNAL REVENUE SERVICE UNITED STATES INFORMATION RETURN FOR CALENDAR YEAR 1957	
BY WHOM PAID	THE T_____ COMPANY DOVER, DELAWARE	

Form 834—Tabulating card type of Form 1099.

Where electronic data processing equipment is used, the magnetic tape carries, for each stockholder account, the account number, stockholder's name and address, dividend check numbers, and a cumulative record of dividends paid. At the end of the year this cumulative record is run off on Form 1099 Tax Reports.

⁶ Sec. 6042, Internal Revenue Code of 1954.

Use of tabulating cards for Form 1099. As the use of tabulating card dividend checks has come into more and more general use, so has the use of a Form 1099 report printed on a tabulating card. (See Form 834.) These forms are made out usually in conjunction with the checks, and are used as check stubs and as controls to audit

STATE COPY RETURN OF INFORMATION AT SOURCE CALENDAR YEAR 19__		AMOUNT SHOWN IS REPORTED IN ACCORDANCE WITH STATE REQUIREMENTS AS TO MINIMUM PAYMENTS REPORTABLE			
		TO WHOM PAID			MARCH
					JUNE
					SEPTEMBER
					DECEMBER
Stockholder Listed Is Resident In State Indicated					
BY WHOM PAID THE T. COMPANY E. ST., NEW YORK CITY (A Delaware Corporation)	CLASS OF STOCK HELD	NUMBER OF SHARES HELD	DIVIDENDS PAID PER SHARE	TOTAL DIVIDENDS PAID IN	
	COMMON \$25.00 PAR				

Form 835—Tabulating card state tax report.

"Outstanding Check" accounts. Some companies microfilm the Form 1099 cards still on hand, representing outstanding checks, at the time that the reports must be forwarded to the Internal Revenue Service.

Use of tabulating cards for state tax reports. Most state tax authorities now permit reports to them to be made on tabulating card forms. Form 835 illustrates a card return which is acceptable in at least two-thirds of the states. One company which uses this form of report imprints the cards after the payment of the first dividend in March. The card is printed to show the name and address of the stockholder, and other information called for by the form, and is punched with a serial number, which is also the stockholder's account number. The stencils are tabbed so that cards are not printed for stockholders residing in states which will not accept this type of report. At the end of the year, the dividend totals are printed on the cards, and the cards are sorted by states, and forwarded to the tax agencies concerned. Reports for the other states are made up separately on forms which they prescribe.

PROCEDURE IN CORPORATION EMPLOYING A DIVIDEND DISBURSING AGENT

Employment of dividend disbursing agent. Many large corporations appoint an agent, usually a trust company, to handle the details involved in the disbursement of dividends. It is a common practice to appoint as dividend disbursing agent the same trust company that acts as transfer agent for the corporation. Appointment of the agent is generally authorized by a resolution of the board of directors. Most trust companies furnish a special form of resolution of appointment, and require a certified copy of the resolution on the prescribed form to be filed with the company as evidence of its authority to act as dividend disbursing agent for the corporation.

Outline of procedure followed by corporation. A corporation that employs an agent for the disbursement of its dividends must take the following steps before the agent can send out the dividend checks to the stockholders:

1. A meeting of the board of directors of the corporation is held and a resolution adopted declaring the dividend.
2. The secretary of the corporation submits to the dividend disbursing agent a certified copy of the resolution declaring the dividend. The dividend disbursing agent usually requires that this certified resolution be submitted in sufficient time before the record date to permit printing of the dividend checks by the record date. The agent also usually requires at least two weeks between the record date and the date on which the dividend is to be paid.
3. The treasurer of the corporation arranges to have the funds necessary for the payment of the dividend in the hands of the dividend disbursing agent at least two days before the dividend checks are mailed out. It is now a common practice to deposit such funds in a special dividend account, first, as a protection to the corporation in the event of insolvency of the bank, in which case such funds would constitute a preferred claim, and second, to facilitate the work of the bank in ascertaining the number of dividend checks actually issued.
4. The secretary of the corporation attends to the publication of

the notice of the declaration of a dividend, if such publication is required by the charter of the corporation or by any stock exchange on which the stock of the corporation is listed. (See Forms 847, et seq.)

5. The secretary of the corporation submits to the dividend disbursing agent notices, stockholder information, and such further enclosures as are to accompany the dividend checks. These enclosures must conform in size with the envelope to be used by the dividend disbursing agent for the mailing of the dividend. The printing of such matter is usually attended to by the corporation, although most dividend disbursing agents maintain adequate facilities that may be utilized in case the corporation should desire to relieve itself of the task. Of course, such notices and other matter should be given by the corporation to the dividend disbursing agent sufficiently in advance so that they may be mailed with the dividend checks.

Procedure followed by dividend disbursing agent. The procedure followed by a dividend disbursing agent in the payment of the dividend is practically the same as that described above used by a large corporation that handles its own dividend payments. The corporation provides a list of stockholders entitled to dividends and the number of shares held by each as of the record date. The dividend agent prepares checks corresponding to that list. Any of the methods of check preparation described above may be used, but in most instances the agent employs the tabulating card method. In the past the agent often issued its own checks, and thus the question arose as to the extent of its liability to meet claims by stockholders. It has now become the accepted practice for disbursing agents to act entirely as agents of the corporations. Dividend checks are corporation checks, signed by officers of the corporation. If the disbursing agent signs the checks, it is clear that such action is performed in the capacity of an agent.

The agent follows up checks that have not cleared the bank after a fixed period and periodically reports to the corporation on "Outstanding Checks." It is usually provided in the resolution appointing the disbursing agent that money representing dividends to stockholders who cannot be located is to be returned to the corporation at the end of a specified period, usually two to six years, with the under-

standing that if any checks are presented to the agent thereafter, they will be paid, and the agent will then be reimbursed by the corporation.

Escheat of dividends. In some states funds represented by dividend checks that remain uncashed because the stockholder cannot be found, escheat to the state after a specified period of years.⁷ If the stockholder appears thereafter, his claim is against the state.

Handling letters from stockholders concerning dividends. If a stockholder writes to the corporation giving a change of address, or complaining that his dividend check has been lost, is in an incorrect amount, or has not been received, the letter should be acknowledged and then referred to the dividend disbursing agent for appropriate action.

Lost dividend checks. Upon receipt of notice from a stockholder that his dividend check has not been received or that it has been lost or stolen, the dividend disbursing agent examines the record of paid dividend checks to ascertain whether or not the check has been cashed. This record is similar to the one described in paragraph 4, page 1183, which is maintained by corporations disbursing their own dividends. A sheet such as that illustrated in Form 836 is then filled out, which serves as a record of the history of the missing check. If the records disclose that the check has not been cashed, an "indemnity letter," as shown in Form 837, is sent to the stockholder for his signature, and upon receipt of the letter, properly signed, a duplicate dividend check is issued and mailed to the stockholder. An entry is then made in the dividend record sheet, showing the issuance of the duplicate check. As a precautionary measure, many agents insist upon the lapse of a specific period, about thirty days, before issuing the duplicate check, during which time the proper department of the bank is notified to stop payment on the lost check. If the examination discloses that the check had been mailed to a wrong address, and had been returned by the post office as "not found," the check will be remailed to the stockholder's correct address. Some companies, whose dividend checks are often for very small amounts, may dispense with the requirement of an indemnity letter, and will issue

⁷ E.g., Pa., 27 P.S. §435; Mich., G.C.A. §567.201; N.J., R.S. §2A:37-13.

Company	
Stock	Div. No.
Name	
Check No.	Amount
Payable	No. of Shares
Has check been returned?	
Has check been paid?	
Check remailed	
Duplicate check mailed	
Change of address made	
Date	
Bank	

Form 836—Lost dividend check search sheet.

Form 837—Indemnity letter sent upon notice of lost dividend check.

TRANSFER DEPARTMENT

..... TRUST COMPANY
 STREET, ... CITY, ...
 RE:

In reply to your communication of we inform you that we mailed the dividend check described below and it has not been returned by the postal authorities.

Date	Number	Amount	Name and Address
------	--------	--------	------------------

If you are unable to locate the above check you may receive a replacement by properly executing the REVERSE side of this form providing the original is still unpaid. Replacement checks will not be issued until 30 days after the date of the original check.

☐ ☐
 We have
 changed the address on our records.
 have not

TRANSFER DEPARTMENT

☐ ☐
 (over)

[reverse side of form]

To the Company,
 Street, ..., ...

The check described on the face of this form has not been received by the undersigned or, if received by the undersigned, has been lost, stolen or destroyed, and the undersigned has not endorsed, transferred or otherwise negotiated said check.

The undersigned requests that payment be stopped on the original check and a new check be issued and agrees to indemnify you against any losses, damage, or further claims which may arise from your doing so.

The undersigned agrees to return the original check for cancellation if it

 should come into ^(his)
 _(her) possession.

 WITNESS

NAME

ADDRESS

DATE

a duplicate check upon notice that the original has not been received or has been lost. If both checks are cashed, an appropriate deduction will be made from the stockholder's next dividend.

PRACTICE IN THE PAYMENT OF STOCK DIVIDENDS

Full shares, fractional interests, and scrip. Upon the declaration of a stock dividend, stockholders frequently become entitled to receive less than a full share of stock. For example, a person owning 1023 shares of X Co. stock when X Co. declares a 20 per cent stock dividend would be entitled to receive 204 full shares and $\frac{3}{5}$ of a whole share. Because of certain stock exchange requirements, stock certificates are generally issued only for an even 100 shares, or for any number of whole shares less than 100. Hence, the stockholder in the above example would receive two certificates for 100 shares each and another certificate for 4 shares. Some provision, however, has to be made for the $\frac{3}{5}$ of a share.

(To avoid the conflicting terminology often met in dealing with

this situation, throughout the following discussion the stockholder's right to receive such a part of a share will be spoken of as a *fractional interest*. The written document representing the fractional interest will be called a *fractional share certificate* or a *scrip certificate*.)

Four methods of handling fractional interests have been applied in practice: (1) "Buy or Sell" orders, the most commonly used method; (2) payment of cash; (3) issuance of fractional share certificates or scrip certificates; and (4) accumulation of credits.

1. "*Buy or Sell*" order form. The most generally used method of handling fractional interests in stock is by the use of an order form by means of which the stockholder orders the corporation to buy for him sufficient additional fractional interests to make up one full share, or to sell for him the fractional interests to which he is entitled as a result of the stock dividend. The order form is registered and is not transferable. The right that it represents must be exercised within a prescribed period of time, usually not more than thirty days. Ordinarily the corporation employs a bank or trust company to act as dividend disbursing agent and to handle the orders as they come in from stockholders. In that case, the form itself and the accompanying letter of instructions, will require the stockholder to send his order directly to the agent. Form 838 sets out the letter of instructions to a stockholder receiving a fractional interest by reason of a stock dividend. Form 839 shows the instructions on the reverse side of that letter. Form 840 is a typical order form. Form 841 shows the reverse side. Upon receipt of the order form, properly completed by the stockholder, a new stock certificate will be issued to him for one full share of stock, or he will be sent a check for the value of his fractional interest, whichever he ordered. Some companies use a special check in payment of the proceeds of the sale of a fractional interest. An example of such a check is shown by Form 842. If the stockholder has ordered the purchase of a fractional interest, he is sent a bill like that shown at Form 843. This procedure has the obvious advantage of avoiding burdening the corporation stock records with fractional interests, and of getting the disposition of the fractional interests completed quickly.

Form 838—Letter of instructions accompany order form.

..... Company
 INCORPORATED
 Street
 NEW YORK, N.Y.

(Date)

To the Stockholders of

..... Company:

The 2 per cent stock dividend declared on, 19.... is payable today to stockholders of record at the close of business on, 19.... This stock dividend has been declared to capitalize a portion of the earnings which the Board of Directors deems desirable to retain in the business.

If your holdings of \$10 par value Common Stock on the record date amounted to an even multiple of fifty shares, only a Stock Certificate is enclosed. If you held forty-nine shares or less, only a fractional interest Order Form is enclosed. Otherwise, both a Stock Certificate and an Order Form are enclosed.

If you have received an Order Form, please read the other side of this letter carefully for information as to the action you should take.

This stock dividend increases the total number of outstanding shares of Common Stock by 2 per cent. It does not increase the percentage of your interest in the Company, but the sale by you of the dividend shares accruing to you, including any fractional interest, would reduce your interest in the Company proportionately.

Basis for Capitalization

The stock dividend was capitalized at \$50 per share of Common Stock. Of the sum of \$50 per share transferred from the earned surplus account of the Company, \$10 per share (the par value thereof) was credited to the capital stock account, and \$40 per share was credited to the capital surplus account. The aggregate charge to the earned surplus account amounted to \$.....; the aggregate credit to the capital stock account amounted to \$.....; and the aggregate credit to the capital surplus account amounted to \$.....

Earnings of the Company and its consolidated subsidiaries for the twelve-month period ending, 19...., were substantially in excess of the aggregate of the amount capitalized for the stock dividend and the amount of cash dividends paid during 19....

Tax Status

In the opinion of Counsel for the Company this stock dividend is not taxable as income to the recipient under present U.S. Federal income tax law. However, if any Common Stock held by you at the close of business on record date or any stock or fractional interest received by you as a stock dividend is sold, the stock dividend must be taken into consideration in calculating the tax basis ("cost") of your shares in order to determine your gain or loss for Federal income tax purposes.

This information is furnished for your assistance, but it is suggested that you be guided by your own tax adviser.

Very truly yours,

Secretary

(over)

Form 839—Notice of arrangements for fractional shares (reverse of Form 838)

IMPORTANT: If you have received an Order Form, the information set forth below should be read carefully. The Order Form represents an interest in your stock dividend and has a definite value.

Arrangements for Fractional Interests

Arising under Stock Dividend

Payable, 19..

No scrip or fractional share certificates will be issued to stockholders, as your Directors believe that the procedure outlined constitutes the most convenient method to accomplish the prompt disposition of fractional interests. Shares of Common Stock to cover the total amount of fractional share interest arising under this stock dividend are being issued to Trust Company of New York, Agent, ... Street, New York, N.Y.

Order Forms

The enclosed Order Form is not transferable, but entitles you, on or before, 19...., to instruct Trust Company of New York, Agent, either:

(a) to purchase for your account the additional fractional interest required to make up one full share, bill you for its cost, consolidate the fractions and deliver to you a certificate for a full share, or

(b) to sell your fractional interest and send a check for the proceeds to you.

For example, if you held fifteen shares of \$10 par value Common Stock on the record date (., 19....), you are entitled to 15/50ths of a share as a stock dividend. You have the option of instructing the

Agent to purchase an additional $35/50$ ths of a share for you, which would then entitle you to one additional full share; or you can instruct the Agent to sell your $15/50$ ths of a share and send you a check for the proceeds.

To exercise either such right, you should mark an "X" in the appropriate box on the Order Form, sign it, and return it in the enclosed envelope to Trust Company of New York.

..... Trust Company of New York, as Agent, will execute such Orders as soon as practicable, for the account of the individual stockholders, at a price determined by the Agent in its discretion which will be based on the currently prevailing market price for Company shares on the New York Stock Exchange. The value of the fractional interest will, of course, vary depending upon the market price of the stock at the time your Order is executed. Trust Company of New York, as Agent, may match and offset purchase and sale Orders. No charge will be made to stockholders for performing these services. The Company has agreed to reimburse the Agent for these costs.

Expiration of Order Forms—Void after, 19....

All shares held to cover fractional interests with respect to which Trust Company of New York, Agent, does not receive completed Order Forms from the holders thereof before the close of business on, 19.... will be sold in due course for the account of such holders, and the proceeds distributed to them. The order form will therefore become valueless after, 19.... On, 19...., all unclaimed and all undeliverable proceeds of such sales will become the absolute property of the Company.

1. TRUST COMPANY Wall Street, New York, N. Y. NO. 		Non-transferable fractional interest in a share of Common Stock to the extent of / 50 the
Please handle my fractional interest in a share of Common Stock of U. CORPORATION as indicated.		
DO NOT FILL IN THESE SPACES—FOR USE OF AGENT ONLY		
BUY	COST	BILL NO.
SELL	CHECK	CHECK NO.
ORDER FORM IMPORTANT Indicate action desired on this fractional interest by an X below. BUY ☐ Bill me for additional fractional interest required for full share. AGENTS ACCOUNT NO. SELL ☐ Send check. If no choice is given, your fraction will be sold. Any purchase or sale made for my account is to be effected in the manner set forth in the letter of 12 Corporation dated 19....		
GIVE SPECIAL MAILING INSTRUCTIONS ON REVERSE SIDE Signature _____		

Form 840—Typical "buy or sell" order form.

U _____ CORPORATION
STOCK DIVIDEND PAYABLE _____, 19__
FRACTIONAL INTEREST—INSTRUCTIONS

You should indicate the action you desire with respect to the fractional interest due you by putting an X in the applicable box and signing where indicated on the reverse side of this card. If this form is not completed and received by _____ Trust Company on or before _____, 19__, the fractional interest due you will be sold and the proceeds of sale remitted to you. If you elect to have the additional fractional interest required for a full share bought for you, and within 45 days after billing your payment therefor is not received, the share held for you will thereafter be sold for your account.

IMPORTANT: If certificate or check is to be sent to other than the address stencilled on the face hereof, please give instructions in space below.

Send to: _____
 (Please Print)

**PLEASE
DO NOT FOLD,
DAMAGE
OR STAPLE
THIS CARD**

Form 841—Reverse of Form 840.

No. **C _____ COMPANY** 1-23
210

INCORPORATED

New York
DATE

MO. DAY YR.

to order of _____

Pay
—Not Good For More Than \$100.—

CHECK FOR PROCEEDS OF SALE
OF FRACTIONAL INTEREST IN A
SHARE OF COMMON STOCK OF
C _____ COMPANY
_____ 19__, 2% STOCK DIVIDEND
Payable at
_____ Trust Company of New York, Agent

004 958

3991

AUTHORIZED SIGNATURE

Form 842—Special check for proceeds of sale of fractional interest.

2. *Payment of cash.* Under this method stockholders who are entitled to less than a full share of stock are paid in cash the value of such fractional interest. Some companies have followed the practice of selling at market a few days in advance of the dividend date an amount of stock equal to the aggregate of fractional interests resulting under the declaration, and then distributing the net proceeds obtained among the stockholders entitled to less than full shares. Objection has been made to this method on the ground that it de-

prives the stockholder of the opportunity to maintain his pro rata holding.

3. *Issuance of fractional share or scrip certificates.* Under this method of handling fractional interests, the corporation issues scrip

No. _____	PLEASE RETURN THIS BILL WITH REMITTANCE TO _____ Trust Company of New York Corporate Trust Division, _____, New York, N. Y.	
In accordance with your instructions we have purchased for your account a fractional interest of <u> </u> / 50 ths of a share of Common Stock of C. _____ _____ Company at a cost of _____		
		AMOUNT DUE
Please return this BILL promptly in the enclosed envelope with your remittance for the amount due. Delivery of the Stock Certificate will thereafter follow.		

Form 843—Bill for fractional interest purchased.

certificates of fractional share certificates to stockholders entitled thereto. They may obtain a full share certificate by presenting enough scrip certificates to aggregate a full share. A market is generally created for the scrip. The corporation must determine, when it issues scrip, whether it will limit the time during which the scrip may be accumulated and presented for exchange for full shares. Such limitation will appear on the scrip certificate. Stock exchange regulations require that the certificates provide that the period within which they may be consolidated into full share certificates cannot exceed two years; that the period within which they may be converted into cash cannot exceed six years; and that the period within which they may be exercised at all cannot exceed six years. Since it is desired to get the scrip out of the way, a provision is often made that no dividends will be paid upon scrip and no voting power granted to it until the exchange is made. The treatment of the outstanding scrip at the expiration of the time limit also varies in practice. Some companies consider the unexchanged scrip dead. Others sell the stock

which they have been holding in reserve to cover the scrip and distribute the funds thus realized among the holders of the remaining outstanding scrip, as and when the scrip is presented.⁸ Form 844 shows an example of a scrip certificate issued by a large corporation. It will be noted that the terms and conditions of the scrip issue are spelled out on the certificate itself.

4. *Accumulation of credits.* Occasionally in cases in which the corporation has adopted a policy of paying dividends either in cash or stock at the option of the stockholder, fractional interests are handled under a plan that provides that an account be kept for each stockholder who has elected to apply his cash dividends to the payment of stock. The account is credited with fractional interests to which the stockholder becomes entitled. A stock certificate is issued as soon as the accumulated fractional interests aggregate one full share. The stockholder receives no dividends or voting rights on his credits. Under this method there is no limitation on the time during which credits may be accumulated. Some of the companies using this plan permit the stockholders to purchase additional credits at any time in order to make up a full share.

Records used in payment of stock dividend. Usually the payment of a stock dividend is handled through the transfer agent. Typical records used by a transfer agent are described below. If the corporation distributes the dividend itself, it will use similar forms.

The list of stockholders is prepared on a form somewhat different from that used for cash dividends. Typical records used for a stock dividend are shown in Forms 845 and 846. It will be noted that the first and last column headings in Form 846 are labeled, whereas those in Form 845 are not. Form 845 is ordinarily used as a report to the principal office of the corporation. A copy may be sent to the office of record of the company in its state of incorporation, if the laws of that state require such a record, and if the principal place of business of the corporation is not in that state. Form 846 constitutes the original issue record of the transfer agent itself, and postings to

⁸ For a full description of some of the methods of using scrip, see Waring, "Fractional Shares under Stock Dividend Declarations," 44 HARV. L. REV. 404.

[illegible]

Form 844—Typical scrip certificate.

the stock ledgers are made directly from these sheets; a single summary entry, the information for which is obtained from the sheets, is made from the transfer record. The spaces at the foot of each sheet are used to record the departmental checking of the issue and the mailing of the dividend.

COMPANY		SHEET NO. 357				
Record of 10% Stock Dividend payable April 15, 19... to Stockholders of record at the close of business April 10, 19... The shares represented by certificates hereon described constitute an original issue						
STOCKHOLDER	SHARES HELD	POSTED	CERTIFICATE NUMBERS	CERTIFICATES ISSUED		
				100's	FRACTIONS	TENTHS
12341			C			
			(Fr)			
			S			
12342			C			
			(Fr)			
			S			
			C			

Form 845—Stock dividend record.

COMPANY		Sheet No. _____						
Record of 10% Stock Dividend.								
Stock Dividend payable April 15, 19... to Stockholders of record at the close of business April 10, 19... The shares represented by the certificates hereon described constitute an original issue.								
REGISTRY NUMBERS	STOCKHOLDER	SHARES HELD	POSTED	CERTIFICATE NUMBERS	CERTIFICATES ISSUED			Date Letter of Acknowledgment Received
					100's	Fractions	Tenths	
				C				
				(Fr)				
				S				
				C				
				(Fr)				

Shipment of _____ Pieces				Called to Figured By Drawn By Audited By Examined By Enclosed By				
COUNTED AND SEALED		DELIVERED TO POST OFFICE BY						
BY	WITNESSED BY	MESSENGER	SPECIAL OFFICER					

Form 846—Stock dividend record, transfer agent.

It will be noted that these particular forms employ terminology that is used by some transfer departments, in that they provide for the issuance of certificates for even 100 shares, for "fractions," and for "tenths." The "tenths" refer to a stock dividend of 10 per cent. Had the dividend been for 20 per cent, this column would have been labeled "fifths." The "C" in the column labeled "Certificate Num-

bers” refers to certificates for 100 full shares; “(FR)” refers to certificates for less than 100 full shares; and “S” to scrip.

FORMS OF DIVIDEND NOTICES

Form 847—Notice of dividend on common stock having par value.

THE COMPANY
..... STREET
..... CITY, ...
..... CONSECUTIVE COMMON DIVIDEND

A dividend of 4 per cent (\$2 a share) has been declared upon the common stock of the par value of \$50 a share of Company, payable in cash on , 19...., to stockholders of record at the close of business on , 19.... Checks will be mailed.

.....
Treasurer

Dated , 19....

Form 848—Notice of regular and extra dividend upon preferred stock.

DIVIDEND NOTICE
..... CORPORATION
CUMULATIVE PARTICIPATING PREFERRED STOCK

At a meeting of the Board of Directors of the Corporation, held this day, it was resolved that this Corporation declare and pay to the holders of its \$..... Cumulative Participating Preferred Stock of record at the close of business on , 19...., a dividend of One Dollar and Sixty-two and One-Half Cents (\$1.621½) per share, being the regular quarterly dividend on said Preferred Stock, and also an extra dividend of Twelve and One-Half (12½¢) Cents per share, payable , 19....

.....
President

Dated , 19....

Form 849—Notice of cash and stock dividend.

The Board of Directors has today declared a dividend of Twenty-five (25¢) Cents per share, payable in cash, and in addition, a dividend of two

and one-half (2½%) per cent, payable in Common Stock, upon the Common Stock of Corporation, both payable
, 19...., to holders of Common Stock of record at the close of business on 19.... Checks and stock and/or scrip certificates will be mailed.

.....
 Treasurer

Form 850—Notice of declaration of cumulative dividends.

..... CORPORATION
 STREET,
 CITY, ...

The Board of Directors, at their meeting held
 19...., declared on the 7 Per Cent Cumulative First Preferred Stock of the Company, a dividend of \$5.25 per share, payable
 19...., to stockholders of record at the close of business on
, 19....

In declaring the above dividend, the directors had in mind the cumulative dividend covering payments due on:

....., 19...., of \$1.75 per share
, 19...., of \$1.75 per share
, 19...., of \$1.75 per share

The transfer books will not be closed. Checks will be mailed.

.....
 Treasurer

Form 851—Notice of election to subscribe to shares to extent of dividends payable.

Date 19....

The Trust Company of New York
 Street
 New York City, New York

Attention of Stock Transfer Department

Gentlemen:

Until otherwise directed in writing, the undersigned holder of Common Stock, Class A, of Corporation, hereby elects to subscribe to additional shares of Common Stock, Class A, to the extent of dividends receivable thereon, and hereby authorizes and requests you

to apply all such dividends to the purchase of additional shares of said stock at the price of \$25 per share, and to issue nondividend-bearing scrip certificates for any fractional shares to which the undersigned may be entitled.

.....
(Signature)

This order must be signed by the party in whose name the stock stands, exactly as the name appears on the face of the stock. If it is signed by someone other than the stockholder, documentary evidence is required.

Form 852—Notice of dividend, including notice to stockholders who have not exchanged stock.

..... COMPANY
PREFERRED STOCK DIVIDEND NO.
COMMON STOCK DIVIDEND NO.

There have been this day declared a dividend of per cent on the preferred stock and a dividend of Dollars per share on the common stock without par value, of this Company, payable Thursday, ..., 19...., to stockholders of record at the close of business Tuesday, ..., 19....

Those stockholders who have not exchanged, as of said record date, their certificates representing the former common stock of the par value of \$100 per share, shall be deemed the owners of two shares without par value for each share of the par value of \$100, for the purpose of the dividend on the common stock.

Checks will be mailed to stockholders by the Trust Company of

.....
Vice-President
.....
Secretary

Dated, 19....

Form 853—Notice of increase in annual rate of dividends on common stock, of declaration of additional dividend, payable in cash or common stock pursuant to such increase, and right to subscribe for additional common stock.

To the Holders of Common Stock:

NOTICE IS HEREBY GIVEN That the Board of Directors of the Corporation, at a meeting held on, 19...., adopted a resolu-

tion declaring the policy of the Corporation to place the common stock on a dividend basis of Ten (\$10) Dollars per share per annum, payable Two (\$2) Dollars quarterly in cash, and the remaining Two (\$2) Dollars payable, at such times, quarterly, semi-annually, or annually, as the Board of Directors may from time to time determine, in cash or, at the option of the Corporation and subject to the approval by the stockholders of the Corporation of an increase in the authorized number of shares of common stock of the Corporation at a special meeting of stockholders to be held on, 19. . . ., in shares of common stock of the Corporation without par value taken at such valuation per share as the Board of Directors shall determine at the time each such dividend is declared.

NOTICE IS ALSO HEREBY GIVEN That, pursuant to such policy and to resolutions adopted by the Board of Directors and Finance Committee of the Corporation, at meetings held on, 19. . . ., the Corporation declared the additional dividend of Two (\$2) Dollars per share on the common stock of the Corporation in respect of the current fiscal year, to stockholders of record on, 19. . . ., payable on, 19. . . ., subject to approval by the stockholders of the Corporation of such increase in the authorized number of shares of common stock of the Corporation, in shares of such common stock without par value taken at a valuation of One Hundred (\$100) Dollars per share, or, in the event of the failure of the stockholders to approve such increase, in cash.

NOTICE IS ALSO HEREBY GIVEN That, at the same meeting, the Board also declared the regular quarterly cash dividend upon the common stock for the quarterly period commencing, 19. . . ., payable on, 19. . . ., to stockholders of record on, 19. . . .

NOTICE IS ALSO HEREBY GIVEN That, pursuant to resolutions adopted by the Board of Directors and Finance Committee of the Corporation at the meetings above mentioned, and subject to the approval by the stockholders of the Corporation of such increase in the authorized number of shares of the common stock of the Corporation without par value above referred to, your Corporation offers to holders of record of its Common Stock at the close of business on, 19. . . ., the right to subscribe, on or before, 19. . . ., for one share of said common stock for each two shares held by such common stockholders (including in the number of shares held the number of shares to which such common stockholder is entitled upon payment of the additional dividend above mentioned), at the price of One Hundred and Seven Dollars and

Forty-nine Cents (\$107.49) per share (which price includes the accrued regular quarterly cash dividend for the period from, 19. . . ., to, 19. . . .). Payment of the full subscription price for said stock may be made at the time of subscription, or, at the option of the subscriber, may be made in two installments, the first to accompany the subscription and the second to be made on, 19. . . .

The stock subscribed and paid for in full on or before, 19. . . ., will be dated as of, 19. . . ., and will be entitled to share in all dividends on the common stock of the Corporation declared to holders of record after that date. The stock subscribed and paid for in installments will be issued on or as of, 19. . . ., and will be entitled to share in all dividends on the common stock of the Corporation declared to holders of record after that date.

Subscribers electing to pay the subscription price in installments will be entitled to deduct One Dollar and Twenty-four Cents (\$1.24) per share from the amount of the second installment, such deduction being an adjustment in respect of the regular cash dividend accruing on one share of common stock for the quarterly period commencing, 19. . . .

Subject to the approval by the stockholders of the Corporation of such increase in the authorized number of shares of common stock of the Corporation, there will be mailed on, 19. . . ., or on the earliest practicable date thereafter, to each holder of common stock of the Corporation of record at the close of business on, 19. . . ., one or more subscription warrants specifying the number of shares of common stock to which the stockholder is entitled to subscribe. Subscription warrants will be issued only for full shares, but where a stockholder is entitled to subscribe for a fraction of a share, a fractional warrant will be issued. No subscription may be made on a fractional warrant, but such fractional warrants with other fractional warrants aggregating in amount one or more full shares will be exchangeable for a subscription warrant or warrants for the aggregate number of full shares represented thereby. Fractional warrants desired by stockholders to complete full shares, or fractional warrants which stockholders desire to dispose of, must be bought or sold in the market, as the Corporation will not sell or purchase such fractional warrants.

Subscription warrants must be returned to the principal office of Trust Company, ... (Street), ... (City), ... (State), on or before, 19. . . ., by the respective stockholders or their assignees, accompanied by payment of

the first installment of the subscription price, amounting to Fifty-three Dollars and Seventy-five Cents (\$53.75) per share, or, if full payment is made, then by payment of One Hundred and Seven Dollars and Forty-nine Cents (\$107.49) per share, in New York funds. In case payment of the subscription price is made in installments, the second installment, amounting to Fifty-two Dollars and Fifty Cents (\$52.50) per share [being one-half of the full subscription price less a deduction of One Dollar and Twenty-four Cents (\$1.24)], the amount of the adjustment in respect of the regular cash dividend accruing on one share of common stock for the quarterly period commencing 19...., must be paid at said office of said Trust Company on or before 19.... All checks must be certified and made payable to the order of Corporation. On the back of the subscription warrant will be found two forms, one to be signed to exercise the subscription right, and the other a form of assignment. Holders of subscription warrants authorizing subscription for two or more shares may exchange such warrants for other subscription warrants for lesser amounts but for the same aggregate number of shares. No subscription or assignment of subscription privilege will be recognized unless made on the forms furnished by the Corporation.

Subscription receipts evidencing payment of the first installment of the subscription price will be issued upon payment of such installment. When the second installment is paid, the subscription receipts for the first installment must be surrendered for cancellation, and stock certificates, or full-paid subscription receipts exchangeable for stock certificates on or after 19...., will then be issued. In case the full subscription price is paid at the time of subscription, stock certificates, or fully paid subscription receipts exchangeable for stock certificates on or after 19...., will be issued at the time of payment.

Form 854—Letter to stockholders explaining passing of dividend.

To the Stockholders of Corporation:

At a recent meeting of the Board of Directors of this corporation, a comprehensive study of the company's past sales, present competitive position, and projected future development was presented. These reports show that our present capacity for production of "Star-Flite," our leading consumer product, is inadequate to meet the estimated future demand for this product. The study recommended that our facilities for the production of this product be expanded in order to take advantage of the favorable market. Inquiry concerning the availability of outside funds for financing this expansion showed interest rates so unfavorable that your

Board of Directors thought a substantial saving could be made if the expansion was financed with company funds.

To obtain the large amount of money needed, as quickly as possible, your Board of Directors has decided to pass by the annual dividend usually sent to you at this time, and to divert the money that would ordinarily be so used into the financing of this venture.

We regret the necessity of this action, but we are sure that the use of the funds in our expansion plan will result in such large profits in future years that the temporary loss will more than be made up, and the final result will be to your advantage.

We have taken this opportunity therefore, to acquaint you with our decision to start this expansion program, and to inform you of the reason for our decision. It is our sincere belief that you will benefit from this action.

Very truly yours,

.....
, President

J. D. Z. 488

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MASTER INDEX

Because of the inter-relationship of these four volumes dealing with the various duties of corporate secretaries, the contents have been indexed, cross-indexed, and classified in one Master Index, which may be found at the end of Volume IV.

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END OF VOL III

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